January 2013 | www.efd.admin.ch

Report on international financial and tax matters 2013

Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
Confederaziun svizra

Swiss Confederation

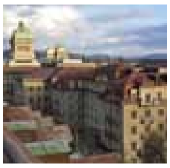
The Federal Council

Imprint

Published by:
Federal Department of Finance FDF
Berne 2013

Edited by:
State Secretariat for International
Financial Matters SIF

Photo 1 cover page:
headquarters of the Federal
Department of Finance, with the
Parliament Building in the background.
Photographer: Thomas Suremann



Translations:
FDF Language Services

Distributed by:
FOBL, Federal Publication Sales
3003 Bern
Fax: +41 31 325 50 58
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www.bundespublikationen.admin.ch

Art. no. 604.001.13E
January 2013

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Preface

The global competition for the best economic and financial policy conditions intensified further in 2012. The debt situation of many countries remains precarious, and the economic outlook is uncertain. This international environment is also putting pressure on the successful Swiss model.

Alongside a wave of new regulations containing increasingly protectionist measures, many countries are seeking to boost their tax receipts, including policies that target their citizens' assets and income abroad. A broad international consensus is forming that efforts by companies to circumvent taxes should be increasingly monitored with the aim of preventing such behaviour.

This presents a challenge to Switzerland and its globally interconnected economy. On the one hand, we want to remain a competitive and successful business location, while on the other hand we are playing our part to ensure progress in the fight against abuses in the area of taxation and a return to international stability. If we are to achieve these goals, we cannot simply trot out the same old arguments uncritically in the face of all resistance and close our ears to new ideas.

With this in mind, Switzerland confirmed in 2012 that it is pursuing a clear financial market policy. The overall view approved by the Federal Council on 19 December 2012 is geared towards the following three objectives:

1. Quality: the financial centre should offer high-quality services for domestic and foreign clients, and contribute to long-term prosperity in Switzerland
2. Stability: only a stable and secure financial centre can function also in crises
3. Integrity: the preservation of integrity is the responsibility of market participants on the one hand, while the state can contribute to combating abuses through an appropriate regulatory and supervisory framework on the other hand.

These words should be followed by actions in 2013. The withholding tax agreements must prove their value in practice, the efficiency of administrative assistance should be scrutinized, market access should be secured with circumspect regulation, and new business areas should be developed thanks to favourable conditions. Switzerland will contribute actively to international financial and monetary stability through key multilateral financial bodies such as the International Monetary Fund (IMF) and the Financial Stability Board (FSB). Furthermore, an independent group of experts appointed by the FDF is preparing a basis for the further development of the Confederation's financial market strategy.

This report, which is being published for the third time, will give you an idea of the multiple challenges being faced in the area of international financial and tax matters. It will also show you how Switzerland wants to turn these challenges into an opportunity to shape a competitive and morally sound Swiss business location.

Bern, January 2013

Eveline Widmer-Schlumpf
Head of the Federal Department of Finance

Overview

In 2012, the Federal Council took a number of important strategic steps in the area of financial market policy. The strategy introduced by the Federal Council at the end of 2009 was supplemented and fleshed out by the report on Switzerland's financial market policy presented at the end of 2012.

The strategic orientation of Switzerland's financial market policy is based on strengthening competitiveness, combating financial crime more intensively, concluding international withholding tax agreements with further countries and setting out standard-compliant administrative and mutual assistance in additional double taxation agreements. An independent group of experts was instructed by the FDF to draw up principles for the long-term orientation of Switzerland's financial market strategy. By putting together three packages of measures consistently geared towards the objectives of quality, stability and integrity, the framework for the Swiss financial centre should also be optimised and gain respect internationally.

A well-functioning and internationally integrated financial centre is in the interests of the Swiss economy as a whole, as it provides financing to many small and medium-sized companies and allows private households to access comprehensive financial services. As a core segment of the economy, the financial centre is a key success factor for Switzerland. Consequently, Switzerland's economic policy should create the best possible and internationally accepted framework.

The economic conditions of the financial centre are significantly affected by developments in the international environment. The sovereign debt crisis is continuing to pose major challenges for both the economy and the financial sector. Furthermore, the requirements for granting market access to providers from other countries have become stricter in the wake of extensive financial sector reforms in various countries. As an additional factor, the fiscal policy of many countries has been increasingly focused on boosting tax receipts. Switzerland will continue to be actively involved in the development of global standards in the future. Internationally recognised standards should in principle be implemented by Switzerland. In the event of non-acceptance, a credible alternative is to be put forward.

Important steps lie ahead in 2013 and beyond:

The Federal Council has prepared the basic concept for the new due diligence requirements for financial institutions. The so-called financial integrity strategy is to be fleshed out and implemented. When accepting new assets, financial intermediaries should take into account not only the risks of money laundering and terrorist financing, but also tax considerations. This can be done using corresponding self-regulation provisions which are recognised and monitored by the supervisory authority.

It also has to be decided how the revised international recommendations on combating money laundering and terrorist financing can be implemented. Serious tax crimes are now to be punishable also under the heading of money laundering. In the event that they suspect serious tax crimes, financial service providers must report these cases to the Money Laundering Reporting Office Switzerland.

As the implementation of these international recommendations and of the due diligence requirements is closely linked, their content has been coordinated from an early stage. Both proposals are to be submitted for consultation at the start of 2013.

With a view to resolving the crisis in a sustainable way and preventing future crises, Switzerland views its involvement in the management bodies of both the IMF and the FSB as being of particular significance. This also includes Switzerland's participation in the concerted international drive to increase the resources of the IMF, as the threat of a systemic crisis continues to loom large.

In the area of taxation, Switzerland wants to further strengthen withholding tax agreements with foreign countries as a credible alternative to the automatic exchange of information. Withholding tax agreements, administrative and mutual assistance in accordance with the international standard and additional due diligence requirements represent effective and forward-looking means of combating abuses in the area of taxation. At the same time, they can help to ensure that the legitimate need for protection of clients' privacy is preserved. The agreements with the United Kingdom and Austria, which will be in force from 2013, should be followed by similar agreements with other countries both within and outside Europe. The status quo will be maintained with Germany, which did not ratify the signed agreement.

With regard to the future framework for business taxation, a solution must be sought that accommodates Switzerland's competiveness as a business location, the budgetary interests of the Confederation and the cantons, and international acceptance. The dialogue initiated with the EU in the summer of 2012 will be continued in 2013.

Regulations in the area of financial market infrastructure and financial services, for example, are to be drawn up in a measured and efficient way, taking international standards into account. The initiatives of particular importance to Switzerland are the financial market regulations in the EU (e.g. EMIR or MiFID II) and in the United States (Dodd-Frank Act).

Traditionally strong in wealth management, Switzerland's financial market has growth potential above all in the areas of asset management, pension funds and the capital market. In order to be able to better exploit this, the Federal Council is prepared to undertake an in-depth analysis of the business environment for the financial centre. Regulatory and tax adjustments should not only improve conditions for existing business areas, but also enable the private sector to develop new business areas.

In implementing its financial market policy, Switzerland will approach the numerous international financial and tax-related challenges in a targeted and coherent manner, and help to ensure that the financial market
- Can offer services of outstanding quality which are valued by clients in Switzerland and all over the world
- Can stand firm even in the face of the severest shocks in volatile international financial and capital markets, and
- Is considered a reliable partner internationally because of vigorously combating abuses.

2012 review

25.01.	FSB praises Swiss financial market regulation
22.02.	Federal Council unveils discussion paper on financial centre strategy
01.03.	Federal Council brings "too big to fail" provisions into force
20.03.	International Monetary Fund (IMF) country report gives Switzerland high marks
20.03.	Switzerland and the United Kingdom supplement withholding tax agreement
05.04.	Switzerland and Germany supplement withholding tax agreement
13.04.	Switzerland and Austria sign withholding tax agreement
18.04.	Federal Council commences work on implementing FATF Recommendations
19.04.	Spring Meeting of IMF in Washington: Switzerland pledges a contribution of USD 10 bn to the increase in IMF resources
21.04.	Signing of Memorandum of Understanding with Poland on cooperation in the IMF and World Bank constituency
21.04.	Switzerland and Australia sign a Memorandum of Understanding on regular financial dialogue
09.05.	Switzerland and Italy agree on dialogue on financial and tax issues
07.06.	DTA with Turkey enters into force
14.06.	Parliament approves IMF quota and governance reforms
15.06.	Parliament approves withholding tax agreements with Germany, the United Kingdom and Austria
21.06.	Switzerland and United States announce declaration on FATCA implementation
04.07.	Federal Council adopts dispatch on framework credit for continuing international monetary aid
04.07.	Federal Council adopts mandate for EU dialogue on business taxation after consultation with relevant parliamentary committees and cantons
06./25.7.	DTAs with Malta, Romania and South Korea enter into force
09.07.	Switzerland and France initial revision of inheritance tax agreement
18.07.	OECD standard for tax administrative assistance: Switzerland approves group requests
01./05.08.	DTAs with Sweden, Slovakia and Singapore enter into force

29.08.	Federal Council adopts mandate for tax and financial negotiations with Italy
29.08.	Federal Council wants better regulation of OTC derivatives trading and financial market infrastructure
07./08.09.	20 years of Swiss membership of IMF and World Bank; Memorandum of Understanding on cooperation in the constituency
27.09.	Parliament approves Tax Administrative Assistance Act
15.10.	Switzerland and Turkey sign a Memorandum of Understanding on regular financial dialogue
15./21.10.	DTAs with Hong Kong and the United Arab Emirates enter into force
07.11.	Federal Council decides on mandate for negotiations on a withholding tax agreement with Greece
09.11.	DTA with Russia enters into force
30.11.	Federal Council adopts dispatch on extending IMF's General Arrangements to Borrow
03.12.	Switzerland and the United States initial FATCA agreement
12.12.	Germany fails to ratify withholding tax agreement
14.12.	Federal Council presents extensive due diligence requirements to combat untaxed assets
19.12.	Federal Council presents overview of financial market policy
19.12.	Switzerland ratifies withholding tax agreements with the United Kingdom and Austria; both agreements thus entered into force on 1 January 2013

1
International developments

Outlook
The global economy should recover hesitantly in 2013, achieving annual growth of between 3 % and 4 %. In the emerging markets, economic output is expected to grow by more than 5 %, whereas growth in the advanced economies is expected to be only around 1 % – with the eurozone likely to stagnate. Switzerland is likely to experience an economic slowdown as well as further consolidation in the financial sector.

The global economy lost further momentum in 2012. The International Monetary Fund (IMF) estimates global economic growth to be 3.3 % (2011: 3.8 %). While emerging market and developing countries continued to drive this growth (+5.3 %) just as they did in 2011, the advanced economies once again lagged behind (+1.3 %). Indeed, the euro area even recorded a decline in economic output, which was driven above all by the debt crisis. Following in the footsteps of Greece, Ireland and Portugal, two other euro area countries sought official assistance in 2012, namely Spain and Cyprus. Further dark clouds looming over the advanced economies include unsatisfactory economic growth and the critical state of government finances in Japan, the United Kingdom and the United States. As 2012 drew to a close, all eyes were on the dispute over a dramatic impending correction to the US budget, the so-called «fiscal cliff».

The central banks of the largest advanced economies succeeded in calming financial markets through a combination of expansive monetary policy and a huge supply of liquidity to the banking sector. The IMF is also helping to contain the crisis by providing significant funds. In many places, however, the extraordinary measures being taken are essentially suspending market mechanisms. There is still a high level of mutual financial dependency between the state and financial institutions in many countries. This is the result of – at least implicit – state guarantees for financial institutions on the one hand, and large holdings of government bonds by these institutions on the other. The potentially vicious circle that this gives rise to remains a key problem for financial stability, and one which could spread to the financial sectors of other countries as a result of global interdependencies. Fears of precisely this kind of contagion were one of the reasons why many financial market protagonists – particularly in Europe – chose to scale down their cross-border exposure in 2012.

This backdrop presents the international sovereign community with three key economic and fiscal policy challenges: The first of these is to improve the state of government finances despite the unfavourable economic environment. The second is to withdraw the various monetary policy and other emergency measures in a timely manner so that market forces can increasingly re-establish themselves. However, normalisation of this kind will require key protagonists in the economy to rediscover their confidence in the ability of the financial markets to function smoothly. Accordingly, the third key task is to ensure a stable monetary and financial system. It was with this in mind that comprehensive international reforms of financial market regulation were initiated in the aftermath of the financial crisis.

As a dynamic and open economy with an internationally oriented financial centre and its own currency, Switzerland faces considerable challenges in this global environment. The subdued situation of the global economy and worldwide consolidation pressures in the financial sector mean that the Swiss financial centre too has an ongoing need for adjustment. Furthermore, the dire financial predicament of State finances is increasingly leading many countries to take decisive steps to look for new sources of receipts

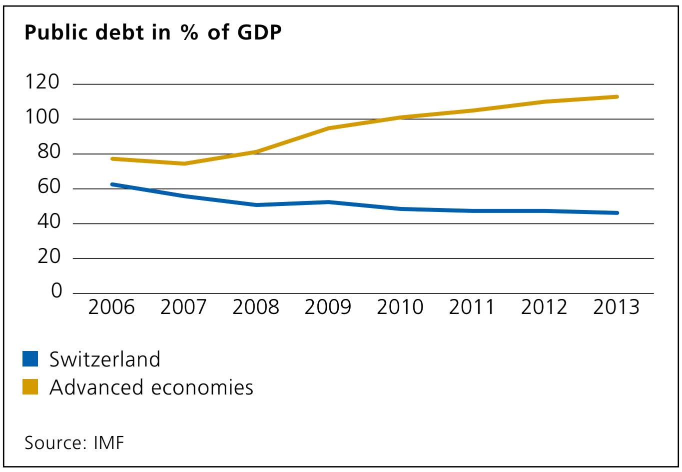


Fig. 1

and prevent the migration of the tax base. This will continue to pose a challenge to Switzerland given its appeal as a business location from a tax perspective. Accordingly, it is important to ensure the best possible, internationally accepted conditions for the Swiss financial centre.

International financial market regulation and implications for Switzerland

Since the financial crisis of 2008, it has been recognised internationally that financial market regulation is in need of reform. Key areas of such reforms include the banking sector («Basel III») and derivatives markets. Moreover, consumer protection should also be improved. The challenge in this respect is to implement these reforms without resorting to protectionism and jeopardising the benefits of open markets. Multilateral bodies such as the Financial Stability Board (FSB) and the IMF play a coordinating and disciplining role here, the former in the area of financial market regulation, the latter through its economic policy monitoring.

Switzerland too is affected by international reforms in the area of financial market regulation, and faces the challenge of helping to shape these reforms and implement them at national level. On the one hand, Switzerland has a vested interest in the enhancement of financial stability that such reforms bring. On the other, the rules governing market access for foreign financial service providers are often revised as part of such reforms. Switzerland must therefore ensure that Swiss financial service providers continue to have access to international financial markets in the future, and enjoy a level playing field with their foreign competitors.

The EU has initiated many technically challenging legislative projects, amongst others with the aim of increasing financial market stability and transparency, and driving forward integration and harmonisation of its single market. This also includes increased use of harmonised market access regimes for third countries in order to overcome the different national regulations relating to third countries in existence up to now.

In addition to the EU's directive on the management of alternative investment funds (AIFMD[1]) and the regulation of over-the-counter (OTC) derivatives (EMIR[2]) (cf. Section 3.3.1), the European Commission's proposal to revise the cornerstone of European financial market regulation – namely the directive covering the provision of financial services (MiFID[3]) – is of critical importance to Switzerland. As a non-member of the European Economic Area (EEA), Switzerland itself is not required to implement the directive. However, Swiss financial intermediaries providing financial services locally or on a cross-border basis for clients in the EU are affected by MiFID in a number of respects.

1 Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No. 1060/2009 and (EU) No. 1095/2010, so-called Alternative Investment Fund Managers Directive (AIFMD)

2 Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, so-called European Market Infrastructure Regulation (EMIR)

3 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, so-called Markets in Financial Instruments Directive (MiFID)

According to the revision proposal of the European Commission dated 20 October 2011[4], market access for financial institutions from third countries should also be regulated in a harmonised manner at EU level. If the proposed regime were actually to be passed, providing services to the EU area from Switzerland on a cross-border basis would be ruled out in many areas in the future. Swiss financial intermediaries would then have to serve small investors domiciled in the EU as well as professional clients exclusively through a branch located in the EEA. Furthermore, such a branch could be established only if Switzerland's regulatory and supervisory framework was recognised as equivalent by the European Commission. This concept of third country regulation is still the subject of dispute within the EU itself.

The requirement to serve clients in the EU internal market exclusively from a branch would have major repercussions for the Swiss financial centre. Such a closure of EU markets would also be disadvantageous for EU financial markets and investors, as it would weaken competition to the detriment of EU investors and jeopardise investment flows into the EU. The federal authorities, in particular the State Secretariat for International Financial Matters (SIF), are collaborating closely with the financial sector to campaign actively against such restrictions with the EU authorities. At a political level, this issue has been raised by the Swiss side at various meetings.

A substantial proportion of the foreign assets managed by Swiss financial institutions belong to clients based in the EU area. Ensuring access to the EU financial market is therefore of particular importance. But the regulatory initiatives of other financial markets, particular those of the United States, also have important repercussions for the Swiss financial centre.

The increasingly comprehensive regulation of the United States reflects a different approach to regulation from that being pursued by the EU. The US approach is based on the principle of extraterritorial application of US financial market law, which means that equivalence requirements are less pronounced. For example, the Dodd-Frank Act[5] and FATCA[6] impose direct obligations on Swiss financial service providers vis-à-vis the US authorities on the basis of their extraterritorial validity (cf. Section 5.2.4). This approach often results in conflicts with Swiss law, thereby subjecting Swiss financial service providers to potentially increased risks.

4 COM(2011) 656 final

5 Dodd-Frank Wall Street Reform and Consumer Protection Act

6 Foreign Account Tax Compliance Act

2 International financial system

Outlook
The implementation of the quota and governance reforms will continue in the International Monetary Fund (IMF). They include a doubling of total quotas, a partial redistribution of the 24 seats on the Executive Board and a review of the quota formula. An extraordinary increase in IMF resources is also being implemented due to the tense economic climate. A strong position on the Executive Board is particularly important for Switzerland given its open economy, significant financial centre, own currency. Although Switzerland is not a member of the G20, the Head of the FDF will attend the meetings of the G20 finance ministers and central bank governors in 2013, at Russia's invitation. Moreover, Switzerland will participate in all preparatory work. In terms of specific issues, Switzerland's focus is on the promotion of sustainable reforms to strengthen government finances and stabilize the financial system. It wants to use its strong position as one of 24 member states on the Financial Stability Board (FSB) and push for an internationally rigorous and binding regulatory framework for financial markets.

2.1 Overview

The current state of the global economy and the financial markets is continuing to pose exceptional challenges for the international community and thus for the multilateral bodies responsible for financial stability (e.g. IMF and FSB). Switzerland actively contributes to key discussions and decision-making in the IMF's Executive Board and the FSB.

Current discussions within the IMF remain focused on the still precarious situation of the global economy and the financial system. The further increase in IMF resources is also being pursued against this backdrop. At the same time, the IMF's governance and quota reforms are being driven forward. This will see a shift in power within the IMF towards the major emerging market countries in particular.

In the FSB, important initiatives are under way with respect to the monitoring of systemically important financial institutions, shadow banking and the development of an identification system for all participants in financial transactions. Overall, the focus of the FSB's activities is increasingly shifting towards the monitoring of implementation of reforms that have already been agreed. In addition, the FSB is currently undergoing a process of governance reform with a view to strengthening it as an institution.

The G20 continues to play a significant role in setting the agenda, above all in matters relating to the regulation and oversight of the international financial and monetary system. Switzerland's efforts, as a non-member of the G20, to contribute to key initiatives of this group have paid off. At Russia's invitation, the Head of the FDF will attend the meetings of the G20 finance ministers and central bank governors in 2013. Moreover, Switzerland will participate in all preparatory work. Its commitment is focused on increased bilateral contacts, activities in multilateral bodies and substantial contributions in terms of content. In particular, Switzerland strives to ensure that it is involved in priority work on financial matters. At the same time, it calls for debates and decisions to take place in the relevant bodies of formal international organisations (FSB, IMF, WTO, OECD, UN).

Bilateral financial dialogues are also an important instrument in this regard (cf. Section 2.4). They allow partner countries to present their positions on the G20 process and international financial institutions, and to identify and discuss shared interests as well as any opportunities and risks that arise when it comes to bilateral financial, tax and monetary issues.

2.2 International financial and monetary issues

The IMF must ensure that financial and monetary developments are carefully monitored both in individual member states and in the financial and monetary system as a whole. At the same time, the IMF is the key body for evaluating the implementation of lending programmes not only in countries such as Greece, Ireland and Portugal, but also in emerging markets and low-income countries such as Georgia, El Salvador, Morocco and the Ivory Coast. In all core areas of IMF activity, i.e. economic policy monitoring and advice, technical assistance and lending, Switzerland works to ensure that the IMF has an appropriate toolkit and a good institutional setup. This also includes modern governance and adequate funding.

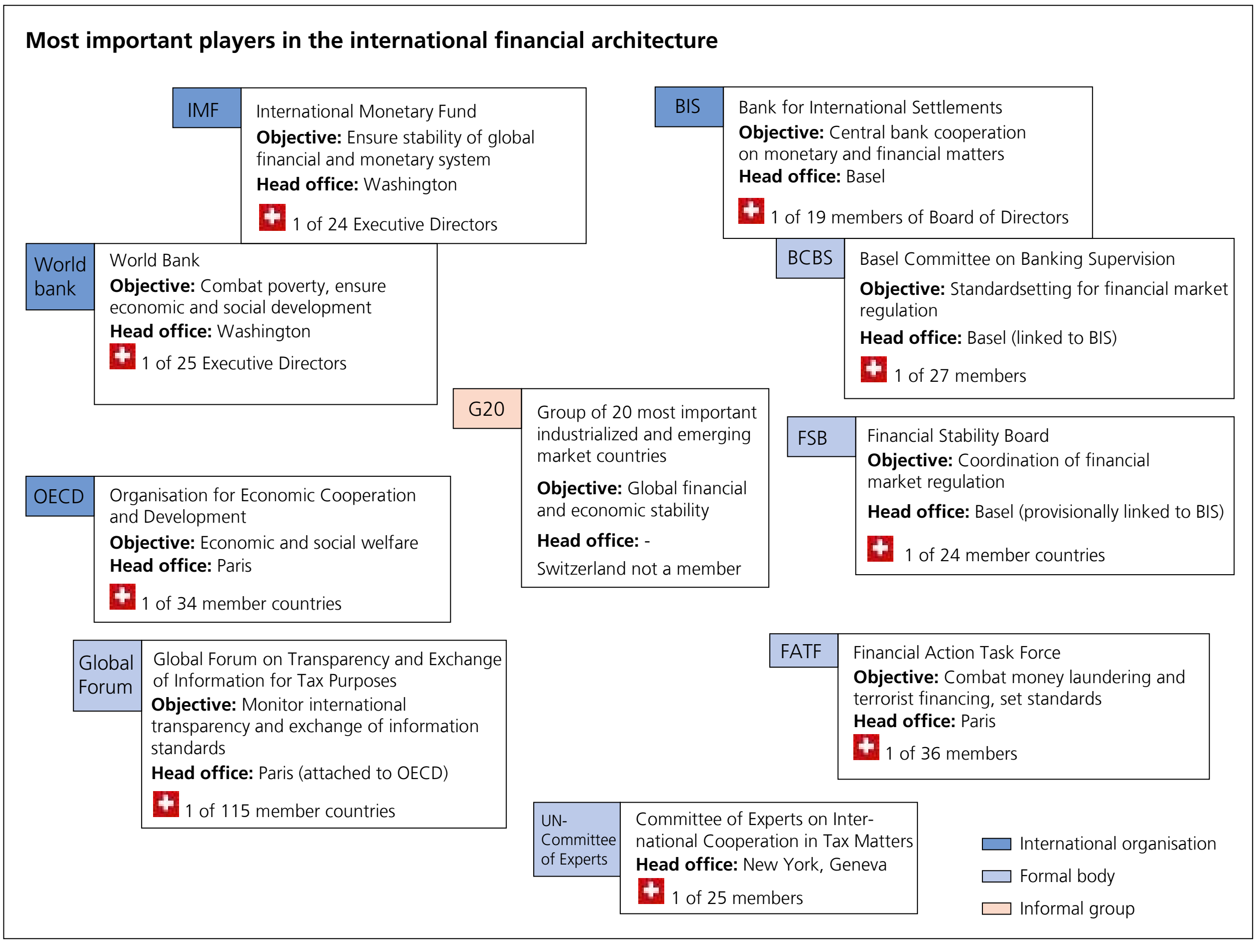


Fig. 2

2.2.1 IMF quota and governance reforms

The strengthening of the IMF's governance is guided by the resolution to reform the IMF's quotas and governance as agreed by the IMF member states in December 2010. As part of these reforms, the regular resources of the IMF provided through quotas are to be doubled (cf. Section 2.2.3). At the same time, there will be a shift of approximately 6 % of quotas to dynamic emerging market and developing countries (EMDCs). The quota increase will take effect as soon as it is ratified by a qualified majority of IMF members. To date, approval by the US Congress, in particular, has still not been given. Switzerland's parliament approved a corresponding proposal in June 2012.

Another reform component is the medium-term reallocation of two Executive Board seats held by advanced European countries to emerging market and developing countries. One seat has already been vacated by the partial merger of the constituencies of Belgium and the Netherlands. The newly created seat will be headed by Austria for two years, before then being transferred to Turkey and a grouping of Eastern European countries in 2014 (see also the current composition of the IMF Executive Board in Fig. 3). Switzerland has signed a Memorandum of Understanding (MoU) with Poland which gives Poland greater leadership involvement in the joint constituency. Under the MoU, Switzerland will maintain overall leadership of the constituency in both the IMF and World Bank. It will represent the constituency in the ministerial bodies – International Monetary and Financial Committee (IMFC) of the IMF and the Development Committee of the IMF and World Bank – in which the political and strategic courses are set. However, Switzerland will share its seat on the

Composition of the IMF Executive Board (end of 2012)

Egypt	Brazil
Chile	China
Denmark	Germany
France	Gambia
India	Italy
Iran	Japan
Canada	Korea
Netherlands	Austria
Russia	Saudi Arabia
Switzerland	Singapore
Togo	United Kingdom
United States	Venezuela

Fig. 3

IMF total credit outstanding and total commitments

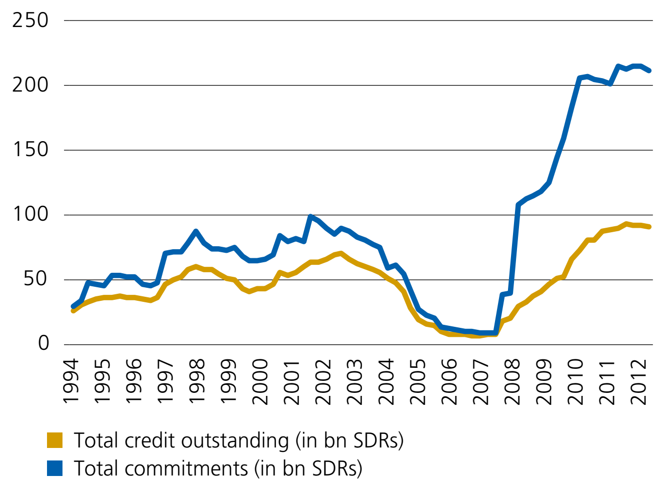


Fig. 4

IMF Executive Board – the IMF's operating decision-making body – and in future both countries will nominate the Executive Director for a two-year period on an equal rotation basis. In this way, Switzerland is contributing to the removal of two seats for advanced European countries. This rotation of the IMF Executive Director position is conditional on the actual implementation of the IMF's governance reform.

Finally, discussions are being held on a reform of IMF quotas and voting rights. IMF quotas play a number of key roles. First and foremost, they are used to calculate member states' maximum payment obligations. In addition, they determine the extent to which countries can call on financial support from the IMF, as well as the voting power exercised by countries on the IMF Board. The quotas are derived from a formula based on the GDP of a country, its economic and financial openness, fluctuations in its trade and capital flows, and its holdings of currency reserves. The quota formula was comprehensively revised for the first time in 2008. This prompted a substantial shift of voting rights towards major emerging market countries. Another revision is to be implemented by the end of January 2013. Switzerland is committed to ensuring that a member's economic and financial interconnectedness are better reflected in the quota formula. It is also calling for member countries' voluntary financial contributions to be taken into account.

2.2.2 Lending by the IMF

In 2012, loan commitments under current IMF programmes remained around the 2011 peak of approximately USD 250 billion. The development of the IMF's loan commitments and the utilisation of these loans over the last 20 years or so are illustrated in Fig. 4. The exceptionally high level of current commitments reflects the continued difficult situation in the financial markets and the global economy. Some 23 countries pursued loan programmes with the IMF in 2012. The most extensive loan programmes were those involving Greece, Ireland, Portugal, Romania, the Ukraine and Iraq. The IMF's flexible credit lines (FCLs) agreed with Mexico, Poland and Colombia, as well as the new precautionary and liquidity line (PLL) agreed with Morocco in 2012, continue to tie almost half of the committed resources. Their renewal will come up in 2013, and Switzerland will again advocate a suitable and swift exit of the IMF from these programmes.

Almost 30 low-income countries pursued programmes with the IMF through the Poverty Reduction and Growth Trust (PRGT) in 2012. This entailed financial arrangements amounting to some USD 5 billion, with an interest rate remaining at 0 % until the end of 2014.

2.2.3 IMF funding

The IMF's regular resources are provided by members via the quota system (cf. Section 2.2.1). The IMF can call on members to supply these resources as required. They earn interest at the prevailing market rate and are typically provided by countries' central banks. In recent decades, the ordinary resources of the IMF have grown much less strongly than the volume of global financial flows.

Following a depletion of the IMF's ordinary resources due to commitments resulting from the ongoing financial and economic crisis, it became necessary to increase the general, i.e. non-subsidised, resources for lending (cf. Fig. 6). This increase in resources and Switzerland's participation in the corresponding measures involves on the one hand the above-mentioned doubling of quotas, which will come into effect once the quota and governance reforms have been ratified. On the other hand, it also involves the expansion of the IMF's backstop for quota resources which entered into force in 2011 (New Arrangements to Borrow, NAB). However, the NAB resources will be roughly halved at the time of the doubling of quotas. Finally, the increase in resources also includes bilateral funding made available to the IMF by its members. This occurred back in 2009 as well, when short-term bilateral credit lines served as bridge financing until the NAB resources could be built up.

At the start of 2012, the serious threat of a destabilisation of the international monetary and financial system led the IMF to conclude that additional resources were required. Responsibility for this replenishment was ultimately taken by key members of the international community of states, and an extraordinary temporary increase in the IMF's resources was agreed at the Spring Meeting of the IMF in April 2012. Total pledges to increase funding amounted to USD 461 billion at the end of 2012.

Within the scope of this internationally concerted action, Switzerland pledged a contribution of up to USD 10 billion, subject to approval by parliament. Switzerland shares the view of the IMF that the threat of a systemic crisis is significant. It has an accordingly strong interest in preventing an escalation of the eurozone crisis, as this could well undermine the global financial system.

The Monetary Assistance Act (MAA) forms the legal basis for involvement in internationally concerted actions to ensure global financial stability.

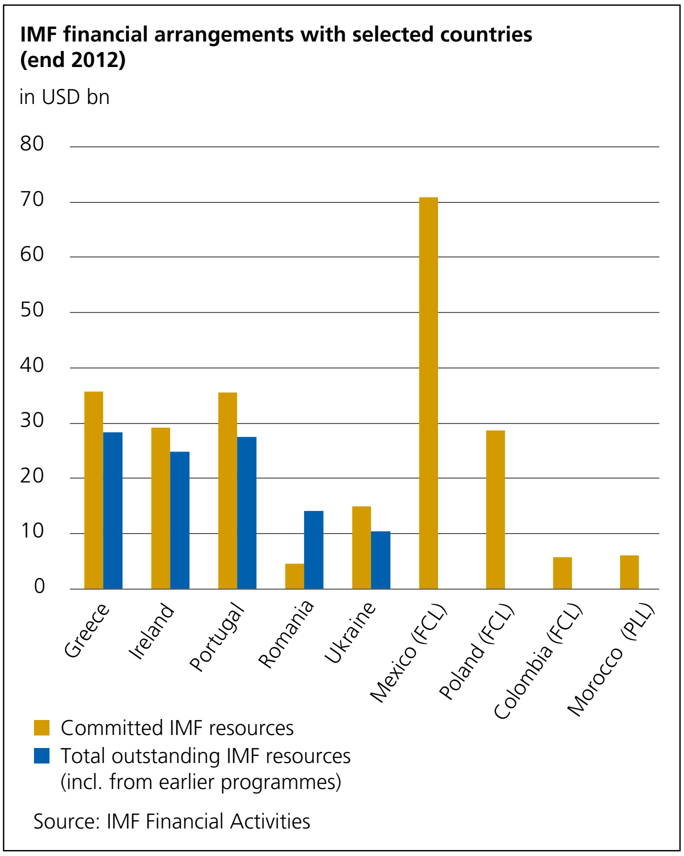


Fig. 5

As in previous years, Switzerland provided no monetary assistance based on the MAA in 2012. A framework credit amounting to CHF 2.5 billion has been available since 2004 for any potential assistance measures required to prevent or remedy serious disruptions to the international monetary system or to support countries which cooperate particularly closely with Switzerland in the sphere of monetary and economic policy.

On 4 July 2012, the Federal Council submitted a dispatch to parliament requesting that the existing framework credit be replaced with a new one of CHF 15 billion. The new framework credit would once again be valid for five years. On the one hand, it should allow sufficient funds to be provided to the Confederation as a guarantee for the SNB's participation in the increase in the IMF's resources as agreed by the IMF's members in April 2012. On the other, it should also ensure that any potential commitments arising from the support measures set out in Articles 2 and 4 of the MAA can continue to be met.

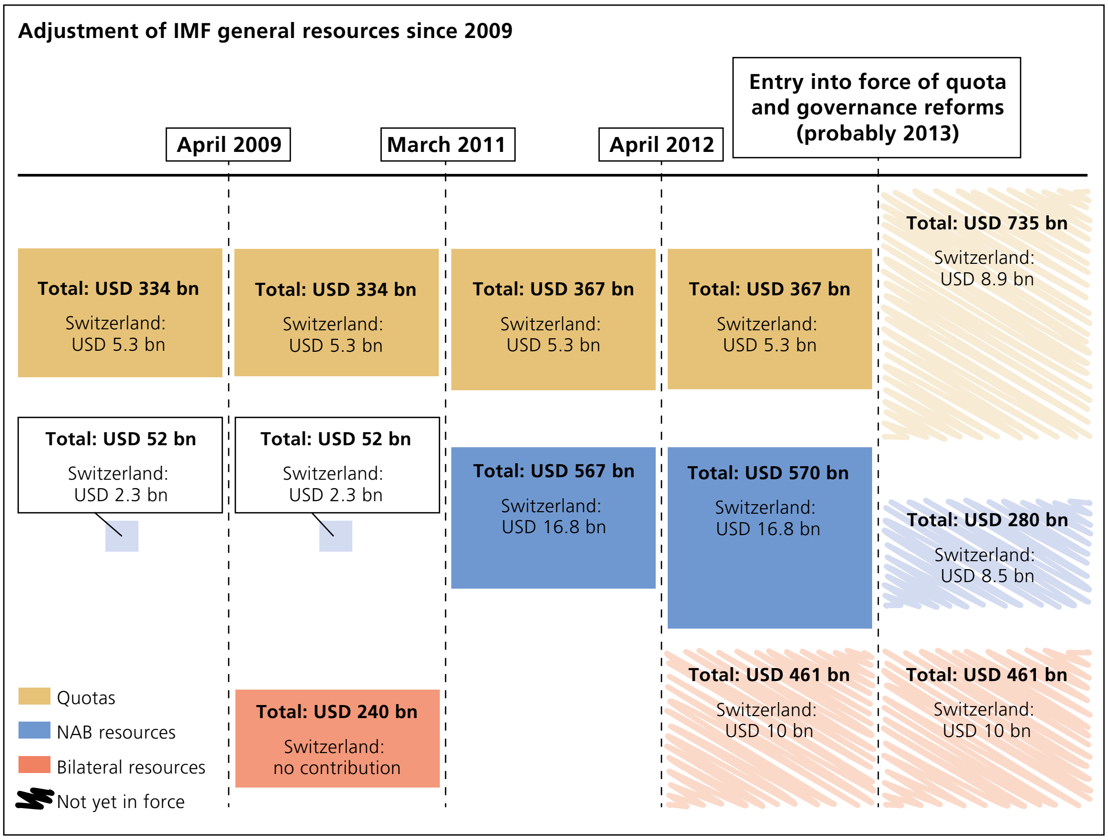


Fig. 6

Aside from its general resources, the IMF's Poverty Reduction and Growth Trust (PRGT) mentioned in Section 2.2.2 is a mechanism that allows the IMF to provide low income members with loans at favourable conditions. It was decided in 2009, in the wake of the financial crisis, to increase these resources. The PRGT now has resources amounting to some USD 40 billion, whereby Switzerland committed a contribution of up to SDR 500 million (around CHF 720 million as at the end of 2012). A corresponding bill was adopted by parliament in March 2011.

The interest subsidy on PRGT loans is financed through bilateral contributions and the IMF's own resources. In 2012, the IMF Executive Board decided to use USD 1.7 billion from the proceeds of gold sales for this purpose. This involves reimbursing the profits already realised from the sale of gold to IMF members in proportion to their respective quotas. It will then be for IMF members to decide whether to support the interest subsidy fund of the PRGT, and if so to what extent. Switzerland's share of the gold sale profits amounts to some CHF 50 million, and will be allocated to the SNB. Any contribution to subsidising PRGT interest is by contrast a responsibility of the Confederation, as has been the case in the past. In discussions within the IMF, Switzerland succeeded in bringing through its longstanding demand to make the PRGT self-sustaining in the future. In addition, a regular review of eligibility will now ensure that the funds are used to assist the poorest countries in a targeted way.

In selected areas of technical assistance, Switzerland maintains a close partnership with the IMF both bilaterally and together with other countries. This includes providing technical assistance to strengthen the financial sectors of emerging market and developing countries, strengthen tax administrations, manage natural resources and combat money laundering and terrorist financing.

In these areas, Switzerland also makes occasionally its own experts available. This typically occurs in response to requests from countries with which Switzerland collaborates closely, such as members of its constituency. In the past, for example, experts in debt management and combating money laundering have been made available for short-term assignments, and country delegations have been invited for presentations on budget management, expenditure controls, fiscal equalization and fiscal rules. In the future, these bilateral assignments are, where possible, to be strengthened and deployed in a more targeted manner.

2.2.4 Switzerland's country report

The regular evaluation of the economic and financial policies of its member states is a core element of the IMF's surveillance activities. The report on Switzerland's annual country review was adopted by the IMF Executive Board on 2 May 2012 and published by the IMF.

The IMF certifies Switzerland's solid economic base. It underscores the risks posed by the eurozone sovereign debt crisis and the challenges associated with the strength of the Swiss franc. The introduction of the exchange rate floor by the SNB in September 2011 is seen as an appropriate monetary policy measure. However, a return to a freely floating currency would be desirable once economic conditions normalise. In order to counter the financial consequences of demographic developments, the IMF recommends taking measures quickly to reform the pension system. Given the environment of persistently low interest rates, the IMF experts see a growing risk of a real estate bubble in parts of the real estate market. Finally, the big banks should raise high-quality capital more swiftly.

2.3 Financial stability

Given Switzerland's significant and internationally integrated financial centre, financial stability is of great importance. The country is thus actively involved in the work of the Financial Stability Board (FSB), which has emerged as the key international forum in the area of stability and regulation of the financial system. Switzerland has two seats on the FSB, which are occupied by the FDF and the SNB respectively.
The FSB is currently undergoing a process of governance reform designed to strengthen it as an institution and make it more transparent. The organisation of the FSB as an association under Swiss law based in Basel and hosted by the Bank for International Settlements (BIS), as approved by the G20 at a summit in June 2012, is scheduled for completion by early 2013. The BIS will continue to meet all the FSB's costs for another five years at least. However, the FSB will have greater autonomy over the use of the funds available to it. The responsible party in this respect is the new Standing Committee on Budget and Resources, on which Switzerland is represented by the FDF.

In 2012, the FSB continued its work on monitoring systemically important financial institutions (SIFIs). At the beginning of November 2012, the FSB published an updated list of the 28 banks currently deemed to be globally systemically important – a list which includes both Swiss big banks. These institutions will be subjected to additional requirements with respect to capital, supervision and resolvability. Moreover, additional standards for systemically important insurers are due to be agreed by the spring of 2013. The International Association of Insurance Supervisors has already unveiled proposals for a methodology for determining the relevant insurers as well as potential regulatory measures.
A further current focus of the FSB is the monitoring of so-called shadow banking systems – such as money market funds. In November 2012, the FSB initiated a public consultation process on recommendations for the regulation of the shadow bank system. These recommendations are expected to be definitively approved in 2013. The aim here is to prevent the migration of risks into non-regulated areas of the financial sector.
A new, large-scale project of the FSB in 2012 involved the development and implementation

FSB member countries

Argentina	Mexico
Australia	Netherlands
Brazil	Korea
Canada	Russia
China	Saudi Arabia
France	Singapore
Germany	South Africa
Hong Kong	Spain
India	**Switzerland**
Indonesia	Turkey
Italy	United Kingdom
Japan	United States

Fig. 7

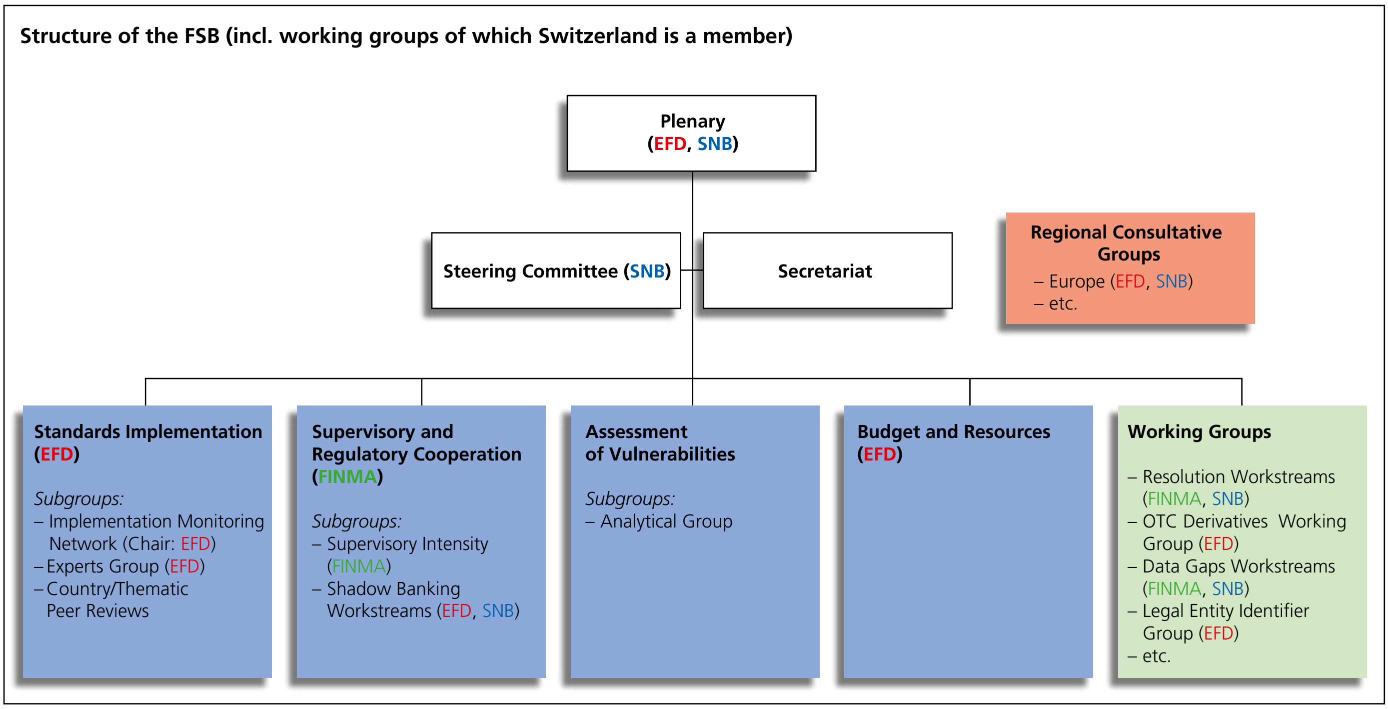


Fig. 8

of a globally universal identification system for legal entities taking part in financial transactions. The legal and operational framework of this Legal Entity Identifier (LEI) system should be in place by March 2013.

Overall, however, the focus of the FSB is currently shifting increasingly from the elaboration of regulatory standards to the monitoring of their implementation. For example, the FSB is continuing to draw up progress reports on implementation of the agreed regulation of over-the-counter (OTC) derivatives trading. Similarly, the FSB is concerned about the lack of progress in the convergence of different accounting standards. In addition, in 2012 the FSB launched theme-based peer reviews in its member states on the implementation of international standards relating to risk management within banks and on national restructuring and resolvability regimes for financial institutions. An annual overview of the implementation of internationally agreed reforms is provided by the FSB's Implementation Monitoring Network working group, which has been headed by Switzerland since 2012.

2.4 Financial dialogues

The aim of financial dialogues is to develop and foster close contacts with the relevant authorities of the partner state in question. Dialogues with individual countries such as Japan and Germany have been taking place for a considerable time now. The aim is to enter into structured dialogues with a number of key partner countries in the financial area, and with (large) emerging market countries in particular. Such contacts should facilitate a regular exchange of opinions and experiences, as well as give rise to collaboration in areas of mutual interest, such as financial market policy and regulation, positioning in international financial forums (e.g. IMF, FSB) and the improvement of early warning mechanisms. Furthermore, financial dialogues offer a framework for starting negotiations with the partner state in question on market access for the financial sector (cf. Section 3.5) or on tax issues, for example. SIF coordinates positions within the administration regarding financial matters in collaboration with other agencies and institutions, and represents these partners in financial dialogues.

As part of a drive to broaden these dialogues, they are now being extended to other G20 countries and to emerging markets in particular. It was possible to institutionalise financial dialogues with new partner countries and thereby create an appropriate framework for structured and ongoing dialogues with the signing of Memorandums of Understanding (MoU) in 2011 (Russia and India) and 2012 (Brazil, Australia and Turkey). In 2012, for example, the first round of financial dialogues got under way with India, Brazil, Australia and Turkey, while a second dialogue with Russia has now been completed. The aim now is to deepen these dialogues. In addition, the SIF has agreed an MoU with the People's Bank of China. A bilateral financial dialogue with China will commence once the MoU has been signed, probably in 2013.

2.5 International activities in the area of customs

International financial matters also concern the area of activity of the Federal Customs Administration.
In the area of customs and indirect taxation, Switzerland has concluded bilateral – or multilateral with EFTA states – administrative assistance agreements with the EU and its member states, as well as with Iceland, Israel, Norway, Colombia, Croatia, Peru, the Southern African Customs Union (Botswana, Lesotho, Namibia, South Africa and Swaziland) and Turkey. In the case of the EU and its member states, these agreements are supplemented by the anti-fraud agreement, which has not yet entered into force but is provisionally applied with certain EU member states. The agreements are above all designed to ensure compliance with customs law and indirect taxation law in connection with the international movement of goods and the detection and prosecution of violations. The Federal Customs Administration provides regular administrative assistance and well as international mutual assistance in criminal matters. Mutual assistance frequently involves the disclosure of bank documents.

Switzerland is currently in contact with the Russian Federation concerning an agreement in the customs area. The negotiations with the United States on an administrative assistance agreement in the customs area have not yet been completed.

3
Competitiveness and market access

Outlook
Differences in regulatory levels can have a strong adverse effect on market access, as well as the integrity and competitiveness of Switzerland's financial centre. For reasons of equal treatment and competitive neutrality, situations should also be avoided whereby similar financial products are subject to different requirements within Switzerland depending on the financial service provider in question. In conjunction with the Federal Department of Justice and Police (FDJP) and FINMA, the FDF is reviewing the need for action in detail and drawing up a consultation draft, together with the necessary legal basis, within the scope of the Financial Services Act project.

3.1 Overview

The framework for the financial market is to be geared towards the objectives of quality, stability and integrity also in the future. However, conflicts of interests can arise when designing financial market regulation. For example, overly stringent regulation could detract from the sector's competitiveness, while the integrity of the financial centre as well as access to foreign markets could be jeopardised if regulation is too lax. For that reason, the costs and benefits must be weighed up carefully when shaping financial market regulations and the attractiveness of Switzerland as a location must be preserved.

The financial market is traditionally an important pillar for prosperity and employment in Switzerland. Given the small domestic market, it is very important for the Swiss financial market to be able to continue to consistently follow an international-oriented approach and improve its competitiveness. An appropriate regulatory framework for the financial market in line with international standards helps to ensure access to international markets.

Several reforms have already been implemented successfully since the financial crisis. A need for further reform has been identified in the area of improving market transparency, as well as in the area of consumer and investor protection. The Federal Council has instructed the FDF to prepare a consultation draft in both areas.

Commodity trading
Over the last few years, and based on a tradition which dates back to the 18th century, Switzerland has evolved into one of the world's key centres for commodity trading. Although the relevant exchanges for physical commodities and commodity derivatives are located abroad, between a quarter and a third of the international commodity trading volumes of companies are carried out from Switzerland.
The role played by commodity derivatives markets and the regulation of these markets have recently become a focus of international debate due for example to the surge in commodity prices and the increasingly important position held by purely financial investors. Among other things, this has fed through into a set of principles drawn up by the International Organization of Securities Commissions (IOSCO) for monitoring commodity derivatives markets. These principles, which are supported by Switzerland, are designed to ensure that markets for commodity derivatives make an efficient contribution to pricing, fulfil their hedging function and are as free as possible from manipulation. Also relevant in this context are the new legal provisions for over-the-counter trading in derivatives which the Federal Council instructed the FDF to draw up in August 2012 (cf. Section 3.3.1). The aim of these provisions is to ensure an increase in the transparency of over-the-counter trading in derivatives, which also takes place in Switzerland.
However, interest in the Swiss commodities sector goes beyond the area of financial market regulation, and is now becoming increasingly prevalent in political circles and the media. Aspects focused on here include the need for companies to assume corporate social responsibility regarding human rights and environmental standards, as well as transparency in the area of accounting. To contribute to the formation of the Federal Council's opinion, it appointed an interdepartmental platform headed by the FDF/FDFA/FDEA with a view to bringing together the available expertise on various aspects of the commodities industry and producing the corresponding documentation.

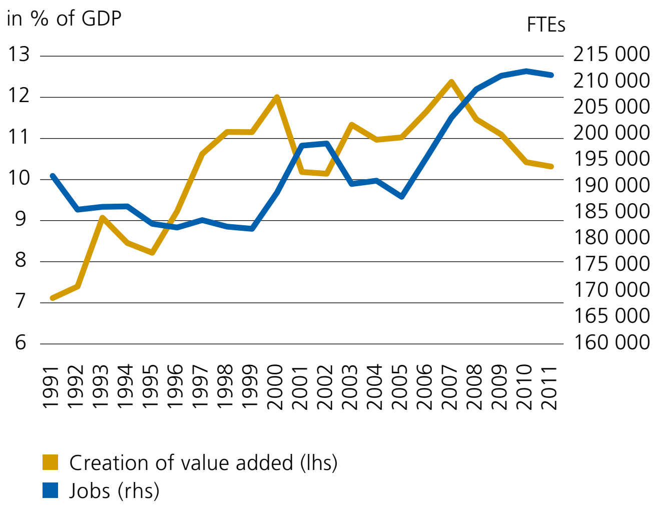
3.2 Significance of the Swiss financial centre

Switzerland's financial centre makes a significant contribution to gross value added and employment (cf. Fig. 9).

In 2011, total value added of just under CHF 61 billion was generated through the provision of financial services. This equates to a 10.3 % share of gross domestic product (GDP), which is similar to the level in other major financial centres: 9.4 % in the United Kingdom, 12.4 % in Singapore and 8.3 % in the United States. However, it is considerably lower than Luxembourg's 28.3 % (cf. Fig. 10). Studies show that the financial sector has been the key growth driver of the Swiss economy over the past 20 years, accounting for around a third of overall GDP growth. From a headcount perspective, 211,000 people were working in the Swiss financial sector in mid-2012. This sector therefore accounts for 6.2 % of overall employment.

Switzerland had a total of 312 banking institutions at the end 2011, almost half of which were foreign banks. Banks are key players in the financial markets, playing an intermediary role between the supply and demand sides where capital is concerned. Thanks to this intermediary function, banks have information on the investment needs of savers on the one hand, and on the investment projects of borrowers on the other. Both companies and private households are reliant on a sufficient supply of credit funding. In mid-2012, the outstanding credit volume, i.e. the amount of credit from banks actually being used, amounted to approximately CHF 1,080 billion. Three-quarters of this amount related to domestic mortgage receivables. Strong competition between the many providers in the Swiss market results in low financing costs in the form of low interest rates and interest rate margins. However, there is also considerable uncertainty in the real estate market. In order to avoid dangerous developments as a result of bubbles forming, it is crucial for banks to pursue a responsible lending policy. So far, the regulatory adjustments that took effect on 1 July 2012 should help to reduce the risk of borrower defaults in the future (cf. Section 3.4.2).
In addition to banks, insurers and pension funds also form part of the financial sector. In 2011, there were 228 insurance companies under regulatory supervision in Switzerland, and more than half of these were active in the property and casualty business (i.e. non-life). The capital investments of Swiss insurers amounted to over CHF 500 billion at the end of 2011. Almost half

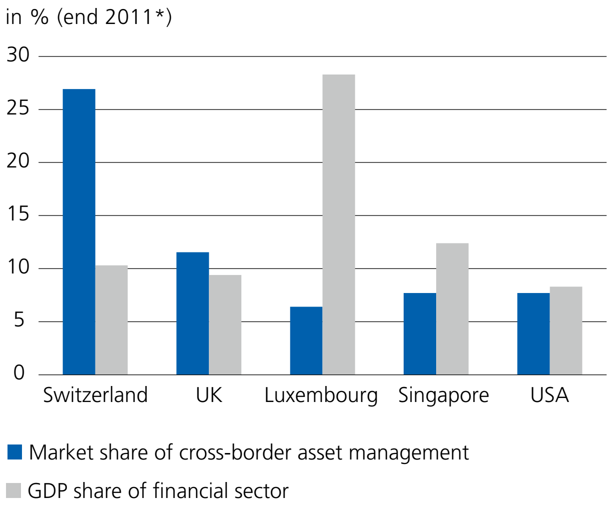
The Swiss financial sector



Source: FSO/SECO

Fig. 9

Financial centre with a high degree of asset management



* Luxembourg 2010

Sources: Boston Consulting Group, FSO, SECO, Office for National Statistics (UK), Statistics Portal – Grand Duchy of Luxembourg, Bureau of Economic Analysis (USA), Singapore Department of Statistics

Fig. 10

of this sum was invested in fixed-income securities. Almost 2,300 pension funds are likewise important players in the financial centre. At the end of 2010, their invested capital amounted to approximately CHF 620 billion, of which over a third was invested in bonds and over a quarter in equities.

3.3 Financial market regulation

3.3.1 Regulation projects

Parliament adopted the amendment of the Federal Act of 23 June 2006 on Collective Capital Investment Schemes on 28 September 2012. The principal objectives of this partial revision were to strengthen investor protection, preserve the Swiss financial centre's competitiveness and reputation, and ensure access to the EU market. Furthermore, regulatory shortcomings were addressed in the areas of management, distribution and custody. During parliamentary consultations, however, the measures proposed by the Federal Council to strengthen investor protection were watered down. One of the key new elements of the revised act is the extension of the legislation to virtually all managers of collective capital investment schemes. Based on the European AIFM Directive of 8 June 2011, a «de minimis» ruling was introduced for smaller managers of collective capital investments, whereby these managers may voluntarily subject themselves to the legislation. New and comprehensive provisions were introduced to cover in particular the managers of collective capital investments, the distribution of such investments, the definition of qualified investors and the liability of custodian banks.

In view of the implementation of the new legislative provisions, the Collective Investment Schemes Ordinance is likewise being revised. The revised act and ordinance will enter into force in March 2013.

The financial crisis highlighted that the lack of transparency on markets for derivatives traded over the counter (OTC derivatives markets) can threaten the stability of the entire financial system due to their strong international integration and the heavy trading volume and default risks. Since then, international efforts have been afoot, in particular undertaken by the G20 and the FSB, to improve transparency and stability in this market. In particular, in September 2009 the G20 nations committed themselves to ensuring that the settlement of standardised OTC derivatives contracts would be effected through central counterparties (CCPs) by the end of 2012, and that all OTC derivatives transactions would be registered with trade repositories (TRs) from that date onwards.

The existing Swiss regulation of financial market infrastructure is no longer appropriate given financial market developments. Furthermore, it also no longer satisfies the new standards developed by international bodies for important financial market infrastructure institutions such as central counterparties and central depositories for securities. International standards in the areas of OTC derivatives trading and financial market infrastructure are currently being implemented in national legislation in several countries. The EU and the United States in particular are relatively far advanced in this area.

To safeguard the competitiveness of the Swiss financial centre and to strengthen financial stability, it is necessary for Switzerland to implement the G20 obligations and the FSB recommendations on OTC derivatives trading as fully as possible and at the same time as other financial centres. In addition, regulation in the area of financial market infrastructure has to be adapted to international standards. In order to secure EU market access, regulation that is equivalent to that in the EU is to be sought in both of these areas. With its resolution of 29 August 2012, the Federal Council instructed the FDF to prepare a corresponding consultation draft by the spring of 2013.

3.3.2 Financial Services Act

It became obvious at the latest during the financial crisis that client protection is inadequate for certain financial services and products. On 28 March 2012, the Federal Council instructed the FDF, with the assistance of the Federal Office of Justice (within the FDJP) and FINMA, to commence work on a project to prepare the legal basis for creating cross-sector regulation for financial products and services and their distribution, and submit a consultation draft to the Federal Council by autumn 2013 (Financial Services Act).

In addition to the shortcomings identified in Swiss consumer protection, such an adjustment of the legislation makes sense for two further reasons. Firstly, the further development of international standards raises questions concerning not only market access but also reputation. Moreover, the same conditions should apply for all providers of financial services.

A need for improvement in Swiss consumer protection is evident in the following areas in particular:[7]

- Regulations for financial products (general prospectus obligation for standardised financial products and a product description for structured products)
- Regulations on the conduct and organisation of financial service providers (such as the financial service provider's duty to provide information; enquiries and suitability clarifications)
- Expansion of supervision (extension to independent asset managers; improvement in the specialist knowledge of persons in contact with clients; same level of protection to apply for clients in cross-border financial services)
- Facilitated enforceability of the claims of private clients under civil law

At an international level, various efforts are under way to strengthen consumer protection in the area of financial services:

- Revision of the EU's Markets in Financial Instruments Directive (MiFID) with a view to harmonising and tightening the rules of conduct which apply to the distribution of financial products
- The analyses on consumer protection drawn up on behalf of the G20 (FSB study: Consumer Finance Protection; OECD paper: Principles on Financial Consumer Protection)
- The principles of «Point of Sale Disclosure» published by the International Organization of Securities Commissions (IOSCO).

These efforts are in line with increasing calls in the EU for consistent and equivalent regulatory standards in consumer protection where the cross-border provision of financial services is concerned. As a consequence of this development, the level of consumer protection affects not only the quality of the financial service provided, but also the reputation of the financial centre and market access for Swiss financial services providers.

Level playing field for financial service providers
Another important prerequisite for strengthening competition between Swiss providers is the uniform structuring of regulatory requirements relating to the provision of financial services. This should revolve around technical aspects such as the complexity of products or the need for consumers to be protected, and should essentially be applied to the same degree for all providers, with the necessary differentiation. By having similar prerequisites, competitive distortions between providers can be avoided.

Work commenced in the spring of 2012 in various working groups – distribution, product, authorisation and supervision, cross-border (provision of financial services) and enforcement. A hearing on the broad outline is planned for February and March 2013. The consultation draft should be complete by autumn 2013.

3.4 Resilience to crises

3.4.1 Implementation of too big to fail measures

Systemically important financial institutions represent a stability risk, as their collapse would entail unacceptable risks for the economy in question. This too big to fail (TBTF) problem is particularly pronounced in Switzerland, as Credit Suisse and UBS have a dominant position in important business areas.

On 4 October 2010, the Commission of Experts appointed by the Federal Council in this area published its final report. The TBTF dispatch was adopted by the Federal Council on 20 April 2011. The bill was adopted by parliament on 30 September 2011. The new provisions entered into force on 1 March 2012.

These measures are designed to minimise the negative repercussions of an insolvency that occurs despite all efforts to prevent such a scenario, and to ensure the continuation of the systemically important functions of the big bank in question. The distorting effect of a de facto

[7] Cf. Position paper entitled «Regulation of the production and distribution of financial products», published on 24 February 2012

state guarantee is greatly reduced as a result. This should prevent a situation whereby the state has to assume major financial risks in the future in order to bail out a systemically important bank.

The measures require a significantly higher level of capital, as well as rules for liquidity, risk diversification and organisational measures at the big banks. New capital instruments (reserve and convertible capital, so-called CoCos) are to help banks implement the more stringent capital requirements. The proposals are based on those of the international Basel Committee on Banking Supervision («Basel III»), but go much further.

The emergency plan, as part of a global restructuring and resolvability plan, should ensure the maintenance of systemically important functions (particularly payment transactions, the deposit business and the lending business) in the event of the insolvency of a systemically important bank. The combined impact of capital and organisational measures has a key role to play. If a bank's capital ratio falls below a certain level, the emergency plan can be triggered, for example with a rapid transfer to a bridge bank. The capital base should be ensured with the equity created by converting the convertible bonds.

The measures set out in the Banking Act are reflected in the new sections of the Banking Ordinance and the Capital Adequacy Ordinance. The Federal Council adopted these ordinances on 1 June 2012. The Federal Assembly also approved them during the 2012 autumn session. The ordinances thus entered into force on 1 January 2013. Moreover, the specific requirements of the new Liquidity Ordinance will be phased in from January 2013. The affected banks have already embarked on the implementation of these measures, and their work is being closely monitored by FINMA.

3.4.2 Implementation of Basel III

The recent financial market crisis has illustrated numerous weaknesses in the international financial system. On the basis of its findings, the Basel Committee on Banking Supervision has issued revised capital and liquidity guidelines («Basel III»). Eleven members, including Switzerland, have already issued definitive Basel III regulations, which entered into force on 1 January 2013. Seven others, including the EU and the United States, have published drafts and stated that they are working on issuing definitive regulations as soon as possible.

In the area of capital, the new standard requires banks to hold significantly more and higher-quality capital in order to absorb losses. Under Basel III, the total capital ratio necessary from 2019 is 10.5 % and the common equity Tier 1 ratio (common shares and retained earnings) is 7 %. Switzerland is subjecting its systemically important banks to even stricter capital requirements (cf. Section 3.4.1).

In order to implement the more stringent international rules, the Federal Council adopted the total revision of the Capital Adequacy Ordinance in June 2012. In accordance with the transitional periods of the international standards, the Swiss Basel III guidelines will enter into force on 1 January 2013. The new requirements, which were elaborated in collaboration with the authorities, the affected institutions and industry associations, will be more rigorous overall but also more transparent and more straightforward. The Swiss implementation of the new capital guidelines include the requirements drawn up under international standards («Basel pur»). Furthermore, additional capital requirements as laid down by FINMA according to the size of the bank in question apply.

Aside from the total revision of the Capital Adequacy Ordinance, the Federal Council also adopted two measures to be implemented immediately, which have been in force since the start of July 2012. A countercyclical buffer is to increase banks' resilience in the event of excessively strong credit growth. Furthermore, in order to ensure banks are immediately more cautious when granting mortgage loans, they must hold more capital for underpinning residential mortgage loans if the borrower does not contribute a minimum of 10 % own funds. This minimum sum may not come from occupational benefits provision (second pillar).

This will not complete implementation of the Basel III standard in Switzerland, however. In addition to the minimum capital requirements sketched out above, the measures also include qualitative standards on liquidity levels. In Switzerland, these standards will be set out in a newly created Liquidity Ordinance. Firstly, the rules require appropriate management and monitoring of liquidity risks. Financial institutions are obliged to take organisational measures and hold liquidity buffers consisting of first-class assets that are unencumbered and highly liquid. They must conduct stress tests and establish an emergency concept for liquidity shortages. These requirements apply to all banks, whereby the type, scope, complexity and degree of risk of the business activity are taken into account. Secondly, banks are to be given quantitative specifications, whereby the ordinance will initially adopt the currently applicable regulations from the Banking Ordinance. However, according to the international timetable, the provisions should be supplemented by the quantitative liquidity standards under Basel III, i.e. replaced by the Liquidity Coverage Ratio (LCR) as of 1 January 2015 and supplemented by the Net Stable Funding Ratio (NSFR) as of 1 January 2018. Finally, the ordinance contains special quantitative requirements for systemically important banks in order to limit the systemic risks emanating from big banks. In terms of content, they are based on the June 2010 agreement between both Swiss big banks and FINMA on the holding of liquidity. In view of the introduction of the LCR and NSFR, banks will be obliged to submit regular reports on their liquidity to FINMA. The ordinance will enter into force on 1 January 2013.

3.4.3 Early warning system

SIF contributes to the strengthening of the competitiveness and stability of the Swiss financial centre in a number of different ways. In 2012, for example, Switzerland's early warning system was enhanced by increasing Swiss knowledge of other important financial centres and conducting an analysis of financial market indicators. This early warning system contains a number of different components:

- Analysis of the structures, strengths and weaknesses, as well as the regulatory developments of key competing financial centres in order to identify international trends and enable detailed consideration of the positioning of the Swiss financial centre. In 2012, the financial centres of Dubai, Hong Kong, Liechtenstein, London, Luxembourg and Singapore were investigated, with the analysis being conducted at two levels. On the one hand, a more in-depth annual country report was drawn up in each case, while on the other – with the exception of Dubai and London – the key political and economic developments were recorded on a monthly basis.
- Mapping and monitoring of changes in international financial market regulations (Früherkennung Finanzmarktregulierung Ausland – FFA) with a view to identifying regulatory developments abroad at an early stage, as well as facilitating analysis and the elaboration of opinions by the Swiss authorities. The early warning system is based on a closed electronic platform to which selected employees of the relevant authorities and industry associations have access.
- Analysis and monitoring of international market indicators of relevance for the Swiss financial market and financial centre in order to anticipate crises and increase the stability of the financial centre. In three conceptually linked formats, financial market development is illustrated in varying degrees of detail. A crucial element here is the observation of the relevant markets with the use of financial market indicators. This analysis is enhanced by monthly theme-specific reports on market development and by in-depth analyses of individual markets.
- Analysis of selected areas of the financial sector in order to increase specialist knowledge as well as to improve the coordination and recognition of industry-specific challenges.
- Half-yearly publication of selected figures on Switzerland as a financial location in leaflet form, designed to facilitate the recognition of future developments.

3.5 Bilateral agreements on market access

The withholding tax agreements with the United Kingdom and Austria (cf. Section 5.2.3) contain in a memorandum improvements regarding bilateral market access. Among other things, these yield benefits for the financial centre. Improvements in this respect will also be sought in future agreements with other countries, such as Italy and Greece.

In the case of market access in the United Kingdom, there is now a specific procedure to be followed by Swiss institutions with respect to the

Continued on page 28

Overview of additional requirements for big banks (additional regulatory minimum requirements in the areas of capital adequacy and organisation)

International developments in the supervision of systemically important banks (as at end 2012)

At an international level and in significant financial centres, efforts are currently under way to introduce additional regulations for systemically important financial institutions (SIFIs). An important basis is formed by the Basel III capital and liquidity guidelines (cf. Section 3.4.2), which impose more stringent requirements for the capital that must underpin risk-weighted assets (RWA), in particular. According to the G20, all important financial centres and member countries are to introduce these guidelines for all banks.* In addition, there are specific requirements for SIFIs in order to limit the risks they pose to financial stability.

In the case of SIFIs, the package of measures of the Financial Stability Board (FSB) to regulate global SIFIs (G-SIFIs) was approved by the G20 on 4 November 2011.** In addition to a size-dependent capital supplement of 1 % to 3.5 % of RWA in accordance with Basel III (5 categories), this also includes requirements in the area of risk management and internal controls. Furthermore, resolvability plans ("living wills") have to be elaborated, while international resolvability should also be facilitated. Among the 28 banks classified as globally systemically important are UBS and Credit Suisse, each of which must accept a supplement of 1.5 % (FSB, November 2012).

Further country-specific or economic area-specific requirements for systemically important banks in the area of capital and organisation are set out in the following table:

	Additional capital requirement	*Additional organisational requirements*	*Regulation status*
CH: *Strengthening of financial sector stability* With the Swiss parliament having passed the TBTF bill to amend the Banking Act on 30 September 2011 and the Federal Council having made the corresponding adjustments to the Capital Adequacy Ordinance and the Banking Ordinance on 1 June 2012, combined with the specific requirements of the Liquidity Ordinance, Switzerland has played a pioneering role in tackling the TBTF problem. (cf. Section 3.4.1).	**CH:** *TBTF regulation* – 19 % of RWA*** , of which at least 10 % to be held as common equity and the remainder in the form of CoCos. – Leverage ratio of approx. 4.56 %.**** **FSB / Basel III:** – Parallel fulfilment of requirements, implemented with the ordinance adjustments of 1 July 2012.	**CH: TBTF regulation** – Global recoverability and resolvability: incentive system with possible discounts on the progressive capital component. – Preparation of a global restructuring and resolvability plan. – Swiss emergency plan to ensure the continuation of systemically important functions in the event of a crisis. **FSB / Basel III:** – Parallel fulfilment of requirements, implemented with the ordinance adjustments.	**CH: TBTF regulation** – Amendment of the Banking Act: entry into force on 1 March 2012. – Amendment of the Capital Adequacy Ordinance and Banking Ordinance: entry into force on 1 January 2013. – Specific components of the new Liquidity Ordinance: phased in from January 2013. **FSB / Basel III:** – Will likewise take effect at ordinance level on 1.1.2013.
USA: *Dodd-Frank Act – restrictions for large commercial banks* The Dodd-Frank Wall Street Reform and Consumer Protection Act has had a major impact on key areas of financial market law in the United States. Among other things, the section of the law known as the "Volcker Rule" puts significant restrictions particularly on proprietary trading by commercial banks holding retail deposits and prohibits them from operating hedge funds and private equity funds. TBTF problem to be effectively limited as a result of this functional separation, which is designed to reduce of the threat of losses arising in the volatile trading business having a serious impact on banking operations which are critical to the real economy.	**FSB:** – Adoption of regulation envisaged. Supplement of 1 % to 3.5 % of RWA.	**FSB:** – Orientation in line with proposals anticipated. **Dodd-Frank (u.a.):** – Organisational requirements for commercial banks regarding the separation of proprietary trading and particularly high-risk business ("Volcker Rule"). – Clearing of derivative transactions. – Planning of even further-reaching structural measures by the Federal Deposit Insurance Corporation, which will be responsible for resolvability.	Entry into force of Dodd-Frank Act on 21.6.2012. Some aspects yet to be implemented by supervisory authorities.

* According to the Basel Committee›s Implementation Report of 29 October 2012, the start of the Basel III transitional phase (1 January 2013) cannot be met by all countries. Moreover, differences have emerged in the way the standard has been implemented.

** As is the case with Basel III, differences exist with respect to both content and timing of implementation in national legislation.

*** Calibration in accordance with the Commission of Experts› report based on the status at year-end 2009; there may be upward or downward changes depending on the development of domestic market shares and of total assets including certain off-balance sheet items.

**** ditto.

	Additional capital requirement	*Additional organisational requirements*	*Regulation status*
EU: *Alignment with FSB proposals and emergency measures* In its proposal of 20 July 2011 regarding the implementation of Basel III in the Capital Requirement Directive IV ("CRD IV"), the European Commission initially refrained from specific SIFI regulation.* The report of the High-Level Expert Group on Reforming the Structure of the EU Banking Sector ("Liikanen Report") to resolve the TBTF problem was then published on 2 October 2012. This report focuses on organisational measures and so-called "bail-in" instruments. Among other things, the volatile trading business should be operated through separate entities. Furthermore, as part of stabilisation measures, the 70 largest European banks have already been obliged to introduce a cushion of pure equity capital of at least 9 % of RWA by the middle of 2012.	**FSB:** – Adoption of regulation envisaged. Supplement of 1 % to 3.5 % of RWA. **EU:** – Emergency measures to combat the debt crisis. 9 % of RWA in pure equity capital by mid-2012. **Liikanen Report:** – Use of bail-in instruments (conversion of debt capital to equity). – Monitoring of capital requirements (under Basel II and III), especially with regard to internal models.	**FSB:** – Orientation in line with proposals anticipated. **Liikanen Report:** – Separation of proprietary trading from other trading activities (in separate legal entity). Separation requirement determined by supervisor. – Other organisational separations with a view to facilitating restructuring and resolvability. – Enhancement of governance and controls of banks (incl. bonuses with bail-in characteristic).	Implementation of 9 % RWA measure largely completed. The consultation of the European Commission on the Liikanen Report was concluded in mid-November 2012. A corresponding regulatory proposal from the European Commission is expected in 2013.
UK: *Ringfencing in accordance with the Independent Commission on Banking (ICB)* In its final report of 12 September 2011, the ICB unveiled proposals to improve systemic stability and strengthen competition in the banking sector. The focus is on the organisational and legal separation of national retail business from investment banking. This necessitates the retail business requiring protection being hived off into its own company. Compared to the Liikanen Report the, proposals of the ICB are more specific and envisage a greater degree of segregation of the various entities from one another. The degree to which these proposals are compatible will only become clear (at the earliest) when the European Commission unveils a concrete draft.	**FSB:** – Adoption of regulation envisaged. **Liikanen Report:** – Emergency measures to combat the debt crisis implemented. – Liikanen Report: Waiting for regulatory proposals. **ICB:** – 17 % to 20 % of RWA at group level and at least 10 % of RWA at retail bank level, partly as convertible capital. – Leverage ratio of between 3 % and 4.06 %.	**FSB:** – Adoption of regulation envisaged. **Liikanen Report:** – Abwarten der Regulierungsvorschläge. **ICB:** – Ringfencing of retail business. The national (probably EEA-wide) retail business must be transferred to a subsidiary company. These units are subject to a ban on wider banking functions (proprietary trading, global retail business, etc.).	ICB proposal of 12 September 2011. Government's legislative proposal was published on 12 October 2012. The comments of the Parliamentary Commission on Banking Standards are expected in early 2013.
D: *Introduction of a bank levy* Germany too will adopt the FSB regulations. Furthermore, Germany has introduced a bank levy for systemically important credit institutions (part of the Restructuring Act), whereby the degree of systemic risk and total assets form the basis for calculating the levy. The revenue will be channelled into a stability fund that can be used to wind up banks in emergencies.	**FSB:** – Adoption of regulation envisaged **Liikanen Report:** – Emergency measures to combat the debt crisis implemented. – Liikanen Report: Waiting for regulatory proposals. **Restructuring Act:** – Bank levy to fund an ex ante fund to finance restructuring.	**FSB:** – Adoption of regulation envisaged **Liikanen Report:** – Waiting for regulatory proposals. **Restructuring Act:** – In an emergency, transfer of systemically important bank functions to a bridge bank which is secured by the restructuring fund. – New regulation covering the bank insolvency procedure. – Extension of executive body liability to 10 years.	Restructuring Act of 9 December 2010. Largely in force since 1 January 2011.

* The introduction of the CRD IV had been envisaged for 1 January 2013. As the bill is currently still being debated by the European Parliament and the Council of Ministers, this introduction will be delayed.

Fig. 11

opening of new accounts, the acquisition of new clients and the management of existing clients. This has created the necessary transparency and legal certainty.

The agreement with Austria was negotiated and signed in 2012. It was possible to remove regulatory and administrative hurdles to market access and the provision of cross-border financial services. The memorandum with Austria on market access envisages improvements in the areas of account and relationship opening, the cross-border provision of financial services, the granting of licences and the distribution of fund products. The details of the implementation of improvements to market access with respect to Austria are set out in a detailed agreement between the relevant supervisory authorities. For Austria, this means implementing provisions on the simplified granting of licences and the cross-border provision of financial services. These will also cover the simplified distribution of fund products. With the support of SIF, FINMA has negotiated an agreement in this respect with the Austrian Financial Market Authority (FMA) which entered into force at the beginning of 2013 together with the corresponding withholding tax agreement.

4
Financial market integrity

Outlook
Switzerland is stepping up its efforts to combat abuses in the areas of money laundering and tax in 2013, with the aim of strengthening the integrity of the Swiss financial centre and the level of trust it has. By swiftly implementing the revised international recommendations on combating money laundering and terrorist financing, Switzerland is emphasising that it gives high priority to the commitments made through its international engagement.

Measures in the area of taxation

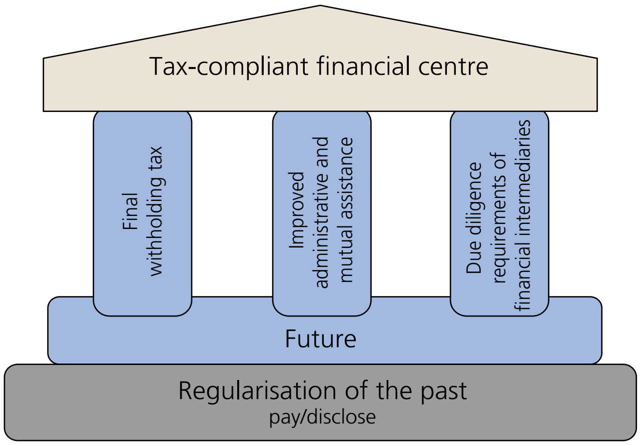


Fig. 12

4.1 Overview
With the enhanced due diligence requirements that apply in the area of taxation and the implementation of the revised recommendations of the Financial Action Task Force (FATF), which the Federal Council will submit for consultation at the beginning of 2013, Switzerland is stepping up its efforts to combat abuses. These initiatives, combined with a number of withholding tax agreements and the provision of administrative assistance in accordance with international standards, mean that Switzerland is creating an effective toolkit for improving the reputation of the financial centre and the level of trust it enjoys. Switzerland is currently in negotiations with a number of other interested countries on a withholding tax agreement similar to those agreed with the United Kingdom and Austria, which entered into force on 1 January 2013. In addition, changes to the Stock Market Act will enter into force in the spring of 2013. These will involve more rigorous provisions regarding the criminal offence of insider trading in particular, thereby making it as difficult as possible for market players to commit market abuses.

4.2 Financial integrity strategy
In its discussion paper of 22 February 2012[8], the report of 14 December 2012, the FDF mandate issued to an independent group of experts and the report of 19 December 2012[9] the Federal Council confirmed and provided more detail on its strategy for a competitive, tax-compliant financial centre.

This strategy is comprised of two levels. At the first level, past tax problems are to be resolved, particularly cases of clients domiciled abroad whose assets have not been properly taxed. The withholding tax agreements with the United Kingdom and Austria provide for regularisation of the past. This will not only facilitate the resolution of past tax problems, but will also solve the problem of potential prosecution of financial institutions and their employees (cf. Section 5.2.3). The past can thus be put to rest and future cooperation with partner states can be established on a new basis. This system of regularisation of past tax problems should serve as a model for further similar agreements.

At the second level, international cooperation and the future taxation of capital income and gains is to be formally regulated, thereby ensuring that the regularisation of the past carried out at the first level is sustainable. This approach encompasses three components:

– The first is a final withholding tax as an effective means of taxing taxpayers in accordance with the rules of their country of domicile while at the same time protecting their privacy. The withholding tax agreements with the United Kingdom and Austria provide for the levying of a final withholding tax on the capital income and capital gains of bank clients. Following payment, the client's tax

[8] Strategy for a tax-compliant and competitive financial centre
[9] Report on Switzerland›s financial market policy

liability vis-à-vis his or her country of domicile is generally deemed fulfilled (cf. Section 5.2.3). This system should serve as a model for further similar agreements.
- The second dimension consists of improved administrative and mutual assistance in accordance with international standards. The Federal Council decided in 2009 to expand administrative assistance in tax matters in accordance with the international standard and to include a standard-compliant administrative assistance provision (Article 26 of the OECD Model Convention) in all double taxation agreements in the long term (cf. Section 5.2.1). In 2010, the Federal Council decided to extend the provision of mutual assistance. The implementation work entailed by this decision is currently under way.
- Finally, the third component consists of introducing due diligence requirements for financial intermediaries in the area of taxation in a bid to ensure that no untaxed assets are invested in Switzerland and to preserve the reputation of the Swiss financial centre both at home and abroad. The consultation procedure on due diligence requirements in the area of taxation will commence at the start of 2013, to coincide with the bill on the implementation of the revised FATF Recommendations.

4.3 FATF

Switzerland is at the very forefront of international efforts to tackle cross-border financial crime and has effective mechanisms at its disposal for combating money laundering and terrorist financing. As a founding member of the FATF, Switzerland is committed to ensuring effective and practicable international standards in the 34 member countries.

The FATF's work under way since the end of 2009 to revise its international recommendations was successfully completed in February 2012. As Co-Chair of the working group tasked with coordinating the revision, Switzerland was able to successfully defend its interests.

Within the scope of its active involvement in the FATF, Switzerland managed, for example, to fend off the proposed abolition of bearer shares and won recognition of the Swiss model of self-regulatory organisation in the definition of the term by the supervisory authorities. Thanks to this recognition, self-regulation is being accepted as the equivalent of state regulation and viewed as a legitimate model for the regulation and supervision of financial intermediaries in the non-banking sector. In the area of tax crime too, Switzerland succeeded in pushing through terminology which takes account of both Swiss interests and Swiss law. The precise definition of tax crime is now a matter for countries themselves, not the FATF.

In order to implement the revised FATF standards, the Federal Council appointed an interdepartmental working group under the leadership of SIF in April 2012 and instructed it to draw up a consultation draft. This draft is due to be submitted to the relevant interested parties at the beginning of 2013, and will primarily encompass the following key initiatives in the area of regulation:

- Qualification of serious tax offences as a predicate offence to money laundering
- Increase in the transparency of legal entities
- Clarification of due diligence requirements with respect to the determination of beneficial owners
- Extension of due diligence requirements to domestic politically exposed persons as well as persons working for international organisations using a risk-based approach
- Introduction of an obligation for payments for purchases above a certain monetary threshold to be processed via a financial intermediary subject to the Anti-Money Laundering Act
- Optimisation of the powers of the Money Laundering Reporting Office Switzerland

The revision will also require countries to conduct analyses of the money laundering and terrorist financing risks originating within their borders and to draw up a corresponding report. Work in this respect will be initiated in 2013 as Switzerland works towards its next FATF country review. Implementation of the revised FATF standards will also make for compliance with the recommendations of the Global Forum.

The FATF's new mandate (2012- 2020) was adopted during a ministerial meeting in April 2012. Switzerland was committed to rationalised governance of the body. It advocated having the new mandate focus on the implementation and consolidation of the standards already adopted rather than on the development of new standards. This should ensure that the processes for verifying implementation of the standards continue to guarantee transparency and equal treatment.

Switzerland likewise advocates equal treatment (a level playing field) in the context of the upcoming FATF effectiveness assessment of anti-money laundering systems in member states and in the elaboration of a detailed evaluation methodology. This methodology should serve as a basis for the fourth round of evaluations, which will get under way at the end of 2013.

4.4 Other organisations in the area of combating money laundering and terrorist financing

Numerous international institutions conduct peer reviews among their members. In the context of the fight against corruption, these include the OECD, the Council of Europe and the UN. An important player in the area of the exchange of information in tax matters is the Global Forum on Transparency and Exchange of Information for Tax Purposes (cf. Section 5.4.2), while the Financial Stability Board (FSB) should also be mentioned in the area of financial stability (cf. Section 2.3). Consequently, the concept of «communicating vessels» has emerged, whereby the results of different evaluations are taken into account in the analyses of the FATF, and vice versa. Switzerland participates actively in specialised international discussions on terrorist financing. In 2012, for example, it contributed to a project of the UN Security Council's Counter-Terrorism Committee Executive Directorate (CTED) aimed at helping developing countries implement UN Security Council Resolution 1373. Finally, Switzerland is working to deliver improvements to global sets of anti-money laundering measures by making a substantial contribution to financing the IMF's trust fund for combating money laundering. Switzerland also contributes to the effective deployment of available resources through its involvement in the Steering Committee.

4.5 Amendment of the Stock Exchange Act

On 28 September 2012, parliament adopted the amendment of the Stock Exchange Act (stock exchange offences and market abuse) proposed by the Federal Council in the dispatch of 31 August 2011[10] without any changes. With the revision, standards will be created at the supervisory and criminal law level to combat market abuse efficiently and take account of international regulations. This will strengthen the integrity and competitiveness of Switzerland's financial centre.

At the criminal law level, the constituent elements of insider trading in particular will be extended and stated more precisely with the revision. It will be transferred from the Criminal Code and written into the Stock Exchange Act, together with the criminal offence of price manipulation. Furthermore, in fulfilling the FATF Recommendations, the criminal acts of insider trading and price manipulation are considered as crimes.

In addition, insider trading and market manipulation will now be prohibited under supervisory law for all market participants. What is more, the scope of application of the provisions on the disclosure of holdings and public offers will be extended to stakes in companies headquartered abroad whose equity securities are listed in whole or in part in Switzerland. Finally, the abolition of the possibility of paying a control premium in the area of takeover legislation is particularly worthy of mention. The legislative revision will probably enter into force on 1 April 2013.

[10] Federal Gazette 2011 6873

5 International tax matters

Outlook
Following on from the United Kingdom and Austria, Switzerland wishes to conclude withholding tax agreements with further states. An agreement for implementing the US tax legislation FATCA is to be entered into with the United States and settlement for the past is being sought. Bilateral relations in the area of taxation are to be consolidated with neighbouring states, particularly France and Italy. In addition, the attractiveness of Switzerland as a business location and international acceptance should be ensured.

Double taxation agreements with administrative assistance provision in accordance with Article 26 of OECD Model Convention:

DTAs in force (30)[1]

Denmark	Germany
Faroe Islands	Finland
France*	United Kingdom
Greece*	Hong Kong
India	Japan
Canada	Qatar*
Luxembourg*	Malta
Mexico*	Netherlands
Norway	Austria
Poland	Republic of Korea
Romania	Russia
Sweden	Singapore
Slovak Republic	Spain
Uruguay	Chinese Taipei (Taiwan)
Turkey	United Arab Emirates

DTAs approved by parliament (2)

Kazakhstan	United States

Signed DTAs (7)

Bulgaria	Ireland
Peru	Portugal
Slovenia	Czech Republic
Turkmenistan	

Initialled DTAs (5)

Australia	China
Colombia	Oman
Hungary	

(Status: 31 December 2012)

[1] Of the DTAs already in force, everything has been done from the Swiss perspective to apply the latest international standard. Only in the case of the countries marked with an asterisk is confirmation of standard-compliant implementation in the partner state still awaited.

5.1 Overview
With the withholding tax agreements with the United Kingdom and Austria[11], a solution was reached which both respects the privacy of bank clients and ensures that the legitimate tax claims of Switzerland's partner countries are implemented. These agreements flesh out the Federal Council's financial centre strategy. Switzerland is prepared to sign agreements of this kind with other countries too. It has initialled an agreement with the United States to simplify implementation of the US tax legislation known as FATCA. Moreover, Switzerland has pushed ahead with the implementation of the international standard in the area of administrative assistance in tax matters. Where company taxation is concerned, the emphasis is on ensuring the ongoing attractiveness of Switzerland as a business location with a competitive tax burden, taking into account the financing requirements of the Confederation and the cantons, as well as international acceptance.

5.2 Bilateral cooperation

5.2.1 Double taxation agreements and tax information exchange agreements
The OECD has drawn up an international standard for tax cooperation (Article 26 of the OECD Model Convention) to which its member states are expected to adhere (cf. Section 5.4.1).
Since changing its policy on agreements in the area of the exchange of information back in 2009, Switzerland has incorporated the administrative assistance provision in accordance with the OECD standard into double taxation agreements (DTAs) which have been initialled with more than 40 states (status at year-end 2012). This opportunity was used to agree numerous improved provisions in agreements (e.g. reduction of withholding tax rates on dividends, interest and royalty payments), eliminate certain cases of discrimination and negotiate arbitration clauses, as well as to enter into new DTAs.
By the end of 2012, parliament had approved 32 DTAs with administrative assistance provisions in

[11] The agreement signed with Germany was not accepted during the German parliamentary procedure

accordance with the latest international standard. Most of these have already entered into force. Switzerland is prepared to adopt a standard-compliant administrative assistance provision in all its existing DTAs, as well as include such a provision in any future agreements. Overall, Switzerland currently has DTAs with more than 80 states. Standard-compliant regulation of administrative assistance is also possible with so-called tax information exchange agreements (TIEAs). Based on the Federal Council's resolution of 4 April 2012, Switzerland can also use a TIEA with states and jurisdictions to govern administrative assistance in tax matters, provided they have submitted a corresponding request to Switzerland or provided Switzerland is interested in such an agreement for tax or development policy reasons. Initial negotiations have commenced with interested territories.

5.2.2 International tax administrative assistance – implementation in domestic law

The administrative assistance clause in the individual double taxation agreements (cf. Section 5.2.1) contains the substantive legal basis for the exchange of information between Switzerland and contracting states. The procedural implementation of the exchange of information is to be governed by the Ordinance on Administrative Assistance under Double Taxation Agreements until the Tax Administrative Assistance Act (TAAA) enters into force. The TAAA was approved by parliament during the 2012 autumn session and will enter into force on 1 February 2013. The new piece of legislation governs the provision of administrative assistance under DTAs and other agreements for the exchange of information in tax matters with respect to both foreign and Swiss requests for administrative assistance. Administrative assistance is provided exclusively upon request. Group requests are permitted. Requests will not be considered if, for example, they have been made for the purposes of fishing expeditions (i.e. requests without concrete indications) or if they are based on information that was obtained through acts punishable under Swiss law, such as the illegal acquisition of data.

In its response to motion 12.3873 («Abolition of the client procedure in the case of administrative and mutual assistance in tax matters»), the Federal Council already declared its willingness to counter the criticism expressed at international level of the obligation without exception to notify persons affected by an administrative assistance request by introducing provisions to cover exceptions. The review of a possible amendment of the Administrative Assistance Act is currently being prepared.

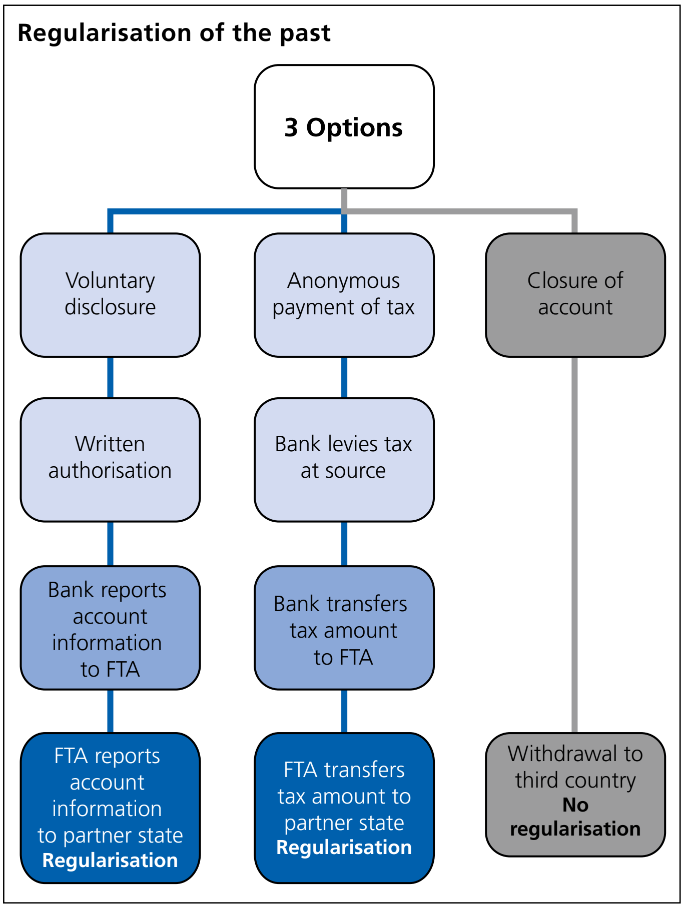


Fig. 14

5.2.3 International withholding tax

As part of the implementation of the Federal Council's strategy to regularise untaxed foreign assets held in Switzerland, while at the same time preserving the privacy of bank clients, Switzerland signed an agreement with both the United Kingdom and Germany in 2011. The agreements provide for a solution that respects the privacy of bank clients on the one hand, while ensuring that the legitimate tax claims of the partner states are fully met on the other. At the end of 2011, the European Commission expressed reservations about the compatibility of the withholding tax agreements with the savings tax agreement between the EU and Switzerland. It was possible to remove the concerns of the European Commission by making corresponding adjustments in the spring of 2012. At the same time, members of the German opposition expressed increasing criticism of the agreement the German government had concluded with Switzerland. The contracting parties subsequently responded to these concerns and in April 2012 signed a protocol which – in addition to making a distinction between this agreement and the savings tax agreement with the EU – includes substantial improvements on the original agreement. The same improvements were subsequently included in the agreement with the United Kingdom too. A further agreement was concluded with Austria on 13 April 2012. The three agreements were approved by parliament during the 2012 summer session. As the move for a referendum against the agreements was unsuccessful, the domestic approval process was completed in the autumn of 2012 without a popular vote.

Withholding tax for the future

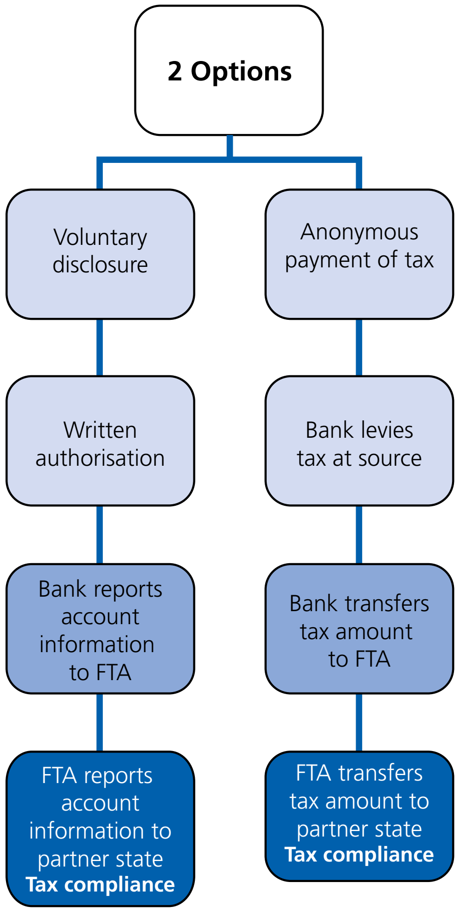


Fig. 15

The United Kingdom and Austria approved the agreements during the course of 2012. Both agreements entered into force on 1 January 2013. In Germany, the agreement was approved by the Bundestag on 25 October 2012, but rejected by the Bundesrat on 23 November 2012. It was not possible to reach an agreement during the conciliation that was subsequently launched. Consequently, Germany's parliament did not accept the agreement.

With the agreements, persons resident in a partner state can retrospectively have their existing banking relationships in Switzerland taxed either by making a one-off tax payment or by disclosing their accounts. In order to ensure that a minimum sum is raised through this regularisation of the past, while at the same time underlining their firm intention to implement the agreements, Swiss paying agents have committed to an upfront payment to the United Kingdom[12]. This sum will be netted off against payments from bank clients to regularise the past, thereby reimbursing Swiss paying agents.

Capital income and capital gains on assets belonging to persons domiciled in a partner state have been subject to a final withholding tax since 1 January 2013. Switzerland forwards the proceeds of this tax to the authorities of the partner state. As an alternative, the individuals affected have the option of authorising their paying agent to report the capital income to the partner state. A similar mechanism is applied in the case of inheritance[13]. The rates for this tax are based on the relevant tax rates applicable in the partner states in order to avoid a distorting effect of tax competition. To ensure the purpose of the agreement, Switzerland has agreed a clause for providing information on request with

[12] The agreement with Austria does not provide for an upfront payment

[13] Given that Austria does not have an inheritance tax, the agreement with Austria does not set out provisions for inheritance

the United Kingdom[14]. Under this clause, UK authorities can submit requests for information to Switzerland. These must contain the name of the client but not necessarily the name of the bank. The number of requests is subject to an annual limit. In all cases, requests must be backed by reasonable grounds. So-called fishing expeditions are not permissible.

It has also been possible to solve the problem of prosecution of bank employees. The partner states will typically refrain from launching criminal proceedings against bank employees for participating in tax offences, or have declared that the criminal prosecution of bank employees for participating in such offences relating to the past is extremely improbable. Moreover, the partner states no longer see any reason for the purchase of illegally acquired bank client data. The agreements also state that the agreed system will have a long-term impact which is equivalent to the automatic exchange of information in the area of capital income. Finally, it has been agreed with the partner states that the cross-border provision of financial services should be simplified (cf. Section 3.5).

Switzerland is prepared to discuss this model with other interested countries. Negotiations are currently being held with Italy and Greece. Other countries both within and outside Europe have shown an interest in this model.

5.2.4 United States

For the past two years, discussions have been going on with the US tax and justice authorities in order to resolve the tax dispute involving a number of Swiss banks. These banks have been accused of abetting US clients in their evasion of US taxes, in violation of US law. Based on a mandate issued by the Federal Council on 26 October 2011, corresponding negotiations have been taking place ever since, with a view to reaching an arrangement for the past with the United States.

Following the publication of a joint declaration by Switzerland and the United States on the bilateral regulation of the implementation of the Foreign Account Tax Compliance Act (FATCA) on 21 June 2012, on 29 August 2012 the Federal Council issued a mandate for negotiations with the United States on a framework agreement for simplified implementation of FATCA in accordance with «Model 2». This model is not based on the automatic exchange of information between the tax authorities of the two states, but on direct reports by Swiss financial institutions to the US tax authorities. On 3 December 2012, Switzerland and the United States initialled an agreement on facilitated implementation of the US FATCA tax legislation. The initialled agreement envisages simplified implementation for key parts of the Swiss financial industry:

– Social security funds, private pension funds, as well as property and casualty insurers are excluded from the scope of FATCA
– Collective investment vehicles and financial institutions with a predominantly local client base are considered to be FATCA-compliant under certain conditions, and are subject to FATCA obligations only for some of their clients as the case may be
– The due diligence requirements for identifying US clients, to which the remaining Swiss financial institutions are subject, have been designed in such a way that the administrative workload involved is kept to an acceptable level

The agreement ensures that accounts held by US persons with Swiss financial institutions are reported to the US tax authorities either with the approval of the account holder, or via the channel of administrative assistance for group requests. If the approval of the account holder is not given, information will not be forwarded automatically, but will be exchanged on the basis of the administrative assistance provision in the double taxation agreement between Switzerland and the United States.

The agreement requires approval by the two chambers of Swiss parliament, and may yet be subject to an optional state treaty referendum.

5.3 European Union

5.3.1 Business taxation

Company taxation is an important component of international competition between business locations. However, the attractiveness of Switzerland's company taxation system is also

[14] An exchange of information that goes beyond the existing double taxation agreement has not been agreed with Austria

causing its international acceptance to be jeopardised, all the more so in the light of the financial turbulence experienced by numerous countries. The EU takes particular exception to the inequality in the tax treatment of domestic and foreign revenues at cantonal level for certain types of company (ringfencing). Switzerland, for its part, is firmly committed to its sovereignty and to open tax competition. However, it is prepared to enter into discussions with the EU on certain business taxation issues that can lead to distortions.

The controversy between Switzerland and the EU in the area of business taxation is nothing new. Back in 2007, the European Commission criticised certain cantonal tax practices as constituting state aid which is incompatible with the 1972 Free Trade Agreement. In June 2010, the EU put forward a proposal to Switzerland to cultivate a dialogue on the adoption of the EU's Code of Conduct for business taxation. This Code of Conduct is an internal political instrument within the EU by means of which EU member states undertake to combat damaging competition in the area of business taxation. The focus is on tax provisions and tax practices that in certain situations lead to significantly lower effective taxation than is customary in the relevant member state.

In exploratory talks, Switzerland and the EU established the framework for initiating a dialogue. After consulting the parliamentary committees and the cantons, the Federal Council adopted the mandate on a dialogue with the EU on 4 July 2012. The Federal Council has defined the following three objectives for the dialogue:

– Preservation and further development of the tax attractiveness of Switzerland as a business location
– Promotion of international acceptance of the Swiss tax system
– Safeguarding of sufficient receipts for the Confederation, cantons and communes to finance government activities

From the Swiss perspective, the dialogue must focus on distortionary tax regimes, particularly those that exhibit ringfencing aspects, as well as on the defensive measures adopted by the EU or its member states. Talks have been under way with the EU since the adoption of the mandate by the Federal Council, and various meetings at the political and technical levels have already taken place between Switzerland and the EU.

In parallel to this dialogue, the OECD Forum on Harmful Tax Practices, which is part of the OECD Committee on Fiscal Affairs, continued to examine special rules for company taxation in November 2012. It also examined 27 tax regimes chosen for further investigation in 2011. The selection includes five Swiss tax regimes, some of which have already been criticised by the European Commission.

The Confederation and the cantons are working closely together on the draft for the third round of corporate tax reforms. This work is closely coordinated with the EU dialogue on business taxation.

5.3.2 Other EU tax dossiers

The EU is currently trying to close existing loopholes in its Savings Tax Directive. On the one hand, further financial instruments (e.g. security-like debt claims, certain life insurance products and structured products) should be taxed. On the other, circumvention of the directive by using intermediary structures should be prevented. Switzerland is prepared, under certain conditions, to enter into talks with the EU on an amendment of the bilateral agreement on the taxation of savings income when the EU has completed its revision of the Savings Tax Directive. A revision should rest on a comprehensive approach such as that adopted in the final withholding tax agreements in order to ensure efficient implementation of the Federal Council's strategy for a tax-compliant financial centre.

In addition, the EU is considering concluding agreements with a number of third countries – including Switzerland – on administrative assistance in tax matters in accordance with the OECD standard (cf. Section 5.4.1). The corresponding negotiation mandate has yet to be issued, however. As Switzerland has agreed the corresponding administrative assistance clauses with numerous EU member states, it considers an administrative assistance agreement with the EU unnecessary.

5.4 Multilateral cooperation

5.4.1 OECD

The OECD has drawn up an international standard for administrative assistance in tax matters to which both member and non-member states are expected to adhere. This standard, set out in Article 26 of the OECD Model Convention and in the model Tax Information Exchange Agreement (TIEA), stipulates that countries must, on request, exchange tax information of any kind and description that is required to enforce the domestic laws of the requesting country. This international standard does not, however, constitute an obligation to provide administrative assistance on an automatic or spontaneous basis. There is automatic administrative assistance when details concerning certain tax-relevant information are systematically delivered to another state. There is spontaneous administrative assistance when a state transmits tax-relevant information that it obtained in a specific individual case to another state because it assumes that it is of interest to that state.

On 17 July 2012 in Paris, the OECD Council approved the amended commentary on Article 26 of the OECD Model Convention (cf. Section 5.2.2). The standard now stipulates that administrative assistance will be provided not only in individual cases, but also in the case of groups of taxpayers. In the case of group requests, the persons concerned must be identified by means of specific search criteria. So-called fishing expeditions, i.e. requests without concrete indications, remain expressly excluded. In Switzerland, parliament approved corresponding regulations within the scope of the enactment of the Tax Administrative Assistance Act. This new standard is not yet the subject of examination in the Global Forum peer review.

The Convention on Mutual Administrative Assistance in Tax Matters of 25 January 1988 (multilateral convention) goes beyond the international standard in some areas. In particular, the convention obliges participating states to provide spontaneous administrative assistance. Moreover, it also contains provisions on the automatic exchange of information, timetables for tax audits, participation in tax audits abroad and assistance in enforcement, although reservations are possible in these areas. The convention was amended by a protocol on 27 May 2010, and now provides for mandatory retroactivity in cases of tax fraud. Switzerland is not a contracting party to the convention. At the G20 summit in November 2011, the G20 states signed this convention, which is advocated by the OECD and the Global Forum, or announced their intention to do so. As the Federal Council made clear in its response to motion 11.4100 («Joining the OECD/Council of Europe Convention on Mutual Administrative Assistance in Tax Matters»), this multilateral convention will increasingly gain in international importance. The Federal Council will review the potential consequences that this development may have for Switzerland.

Furthermore, the OECD Committee on Fiscal Affairs has announced its intention to combat base erosion and profit shifting (BEPS) and launch a corresponding project. Among other things, the project will determine whether and why taxable profits are attributed to locations other than the location where the economic activity actually takes place. The ultimate goal is for states to have a coordinated strategy against base erosion. As a member of the OECD, Switzerland will closely monitor the BEPS project's progress as well as any implications for Switzerland itself.

5.4.2 Global Forum on Transparency and Exchange of Information for Tax Purposes

The Global Forum is responsible for reviewing compliance with the OECD standard in the area of transparency and the exchange of information for tax purposes by means of a holistic process called the peer review. In addition to these reviews of 118 current members, reviews are also being conducted of jurisdictions which are not members. The aim is to prevent certain countries from gaining a competitive advantage from their refusal to apply international standards or to join the Global Forum.

The peer review is broken down into two phases. Phase 1 involves investigation of whether or not the necessary legal foundation exists for transparency and the exchange of information. Phase 2 looks at the effectiveness and efficiency of the exchange of information in practice.

Switzerland has gone through the first peer review phase in 2011. The report certifies that Switzerland has made «important changes» regarding administrative assistance. However, it concludes that Switzerland does not fully meet all the criteria, particularly with respect to the effective exchange of information. The identity of holders of bearer shares cannot be determined in all cases under Swiss legislation, and the requirements for identifying the relevant taxpaying individuals and information holders (e.g. banks) remain too restrictive in requests for information. Furthermore, Switzerland is still unable to exchange tax information with all important partners and except in exceptional cases Swiss law does not provide for the transfer of data within the scope of tax administrative assistance without informing the affected person. The Global Forum recommends that Switzerland take corresponding measures.

With respect to the Global Forum's recommendation regarding the identification of the affected taxpayers and information holders, Switzerland has already made the necessary adjustments in order to comply fully with the standard. Implementation work for the other measures is still ongoing. In order to be admitted to the second phase of the Global Forum's peer review, Switzerland must implement at least one of the points that were only partially or not at all fulfilled.

The Global Forum will soon have completed phase 1 and will then begin the more wide-scale phase 2 review of the efficiency of the exchange of information in practice. The phase 2 reviews involve the individual assessment of all important points as well as an overall assessment.

5.4.3 UN

As a subsidiary body of the Economic and Social Council of the United Nations, the UN Committee of Experts on International Collaboration in Tax Matters is responsible for adapting the UN Model Convention for the avoidance of double taxation to current developments. This body also offers a framework for dialogue to improve and promote international collaboration in tax matters between national tax authorities on the one hand, and between developing and advanced countries on the other. Furthermore, it reviews how new issues could impact this collaboration. The Committee is also responsible for issuing recommendations for building up the capacities of (and the provision of technical assistance to) developing countries and countries undergoing a process of transition to a market economy. The revised Model Convention and its commentary (2011 status) were published in May 2012. At its meeting of October 2012, the Committee approved a handbook of transfer pricing which should provide developing nations in particular with support in the use of transfer pricing. As the four-year mandate of the 25-person committee of experts will expire at the end of June 2013, the committee members will be appointed by the UN Secretary-General this year.

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